United States Court of Appeals
for the Second Circuit

APPENDIX

ORIGINAL WITH PROOF OF SERVICE

77-7098

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

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P/S

RICHARD I. CLARK, as Executor of the
Estate of BERNICE C. GRUPE,

Plaintiff-Appellee,

-against-

JOHN LAMULA INVESTORS, INC. and
JOHN J. LAMULA,

Defendants-Appellants.

ON APPEAL FROM A FINAL JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES COURT OF APPEALS
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JOINT APPENDIX

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HARRY ROWNEY,

called as a witness by the plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BLUM:

Q. Mr. Rowney, where are you employed?

A. I am employed with the investment firm of Drexel, Burnham & Company.

Q. In what capacity are you employed with that firm?

A. I am a vice president with the Investment Advisory Department of Drexel, Burnham & Company.

MR. GOLDSTEIN: Your Honor, I have already stipulated with Mr. Blum as to Mr. Rowney's expertise and I think it would save time if we proceed from there. I concede Mr. Rowney is an expert in the investment area.

THE COURT: All right.

MR. BLUM: I think it might be helpful, your Honor, without going through all of his credentials to establish, so the jury will understand, what his background has been in certain areas.

THE COURT: All right, but keep it as brief as you can.

MR. BLUM: I will, your Honor.

Q. Mr. Rowney, where did you attend college and business school?

A. I attended college at Trinity College in Hartford, Connecticut and I attended business school here in New York at Columbia University.

Q. And from the time that you graduated from business school until today, is it fair to state that your activities have been entirely in the securities and investment counselor's industry?

A. That is correct.

Q. Can you name for us, perhaps just quickly, consecutively the firms for which you were employed, without giving the dates, mentioning titles where they were relevant?

A. I started out with J. P. Morgan & Company as a trainee.

Left there after a few years to join the investment counseling firm of E. W. Axe in Tarrytown, New York where I was employed as a junior securities analyst and junior economist.

From there, I went to a division of Forbes Magazine, a financial magazine which had an investment counseling subsidiary and from there I went to an investment counseling firm of Templeton, Dobbrow & Vance in

Englewood, New Jersy. And then up to about 1969 --

Q. What office did you hold there in Dobbrow & Vance?

A. I was a vice president and director of the corporation.

In 1969 I joined the investment advisory firm of Starwood Corporation as Director of Research and as Executive Vice President.

In '72 I guess it was, I was recruited to organize an investment counseling operation as a subsidiary of the investment banking firm of Ladenburg, Thalmann & Company where I was President of that division. That division was sold to Drexel, Burnham & Company about two years ago where I am now.

Q. Is it fair to state that in the course of your work at these various firms, you have been involved in counseling individuals and organizations with regard to their investments?

A. That is correct.

Q. And in making analyses of investment portfolios and investment recommendations?

A. That is correct.

Q Mr. Rowney, have you at my request examined the investment quality of the convertible subordinated debentures which are indicated in at least by reference on the chart which is over there as they were in the spring and summer of 1974?

A. I have.

Q. Let me ask you a hypothetical question, Mr. Rowney.

Withdrawn.

Let me ask you this. Before this week, did you know the plaintiff, Bernice Grupe?

A. I did not.

Q. Have you ever had a discussion with her before this week that related to the matters which are being litigated here?

A. I have not.

Q. Let me ask you then a hypothetical question.

Assume that in April or May of 1974 you were consulted by a single woman in her late fifties, living alone, and with no dependents who advised you that she had just received about 110 or $120,000, that she had no other expectation of receiving any sums of money, that she had a temporary job liable soon to end which paid her $150 a week and she had a State Teacher's Retirement System pension which provided her $2,000 a year.

Assume further that she told you that the money she had just received was all that she owned, that she had no stocks or bonds or other investments and that she never had any experience in the stock market or in securities transactions.

Assume that she asked you for advice and recommendations for the investment of $100,000, which she described to you as all which she had and which she at that time had on deposit with the Bank of New York in the form of a certificate of deposit bearing interest of perhaps 8 percent per year.

Assume further that she told you that she wanted safe investments and that she reckoned that she would need about $12,000 a year to live on everything considered.

Now, Mr. Rowney, under those circumstances and based on your experience in investment counseling, would you have recommended to this hypothetical client in the spring of 1974 that she invest that sum of money in these debentures?

A. Absolutely not.

Q. Is there any denomination which is common in Wall Street or in the securities business which applies to debentures of this sort which you looked into?

A. There is a slang expression for low-grade securities of this type and they are called junk bonds.

Q. With regard to the answer which you gave, was it relevant in any way in your consideration that it was the spring of 1974?

A. Oh, absolutely.

Q. What was there about it being the spring of 1974 which, in your expert opinion, was relevant to the investment determination which you hypothetically provided?

A. In the spring of 1974 here in the United States and in most of the industrialized world we were facing for the first time since the 1930's the prospects of a serious economic collapse. No one knew exactly what the future would bring but we were witnessing then and had been witnessing for about eighteen months what we called Europeanized rates of inflation taking place in the United States.

In Europe we were seeing inflationary rates of better than 30 percent, in Britain and in Italy and dislocations which these were beginning to cause. In particular to the banking system, so that by the time we got to 1974, we had seen a couple of prominent bank failures in Europe and a couple of prominent bank failures here in the United States, most noteworthy in the New York area the Franklin National Bank and Security National Bank, failure is not quite the right word, they had to be bailed out by the Federal Reserve in one form or another. They were acquired by other banking interests.

The rate of inflation here in the United States was beginning to have a serious consequence in terms of overall economic activity. The unemployment rate was beginning to climb. Commodity prices had begun to soar and there were noteworthy shortages developing. The most serious commodity problem related to oil.

In the winter of 1973 we were, I believe the world was threatened with the Arab oil embargo. We were all standing on line waiting to get gas for our cars and we saw the price of oil quadruple. These dislocations, these economic happenings were such that we had not seen anything of this like at least since the late twenties or the early thirties.

In addition, as part of this inflationary cycle which was taking place, we saw the price of money -- money is just another commodity like wheat or oil -- beginning to climb also. It was climbing to the point where interest rates on key securities here in the United States were at their loftiest levels since the end of the Civil War, so that there was none of us living today who had had that type of direct experience in the United States with this type of occurrence.

On top of all this, we were faced with, for the first time since the end of the Civil War, with the threat of an impeachment of a President of the United States The political consequences of which could not be measured.

All of this was the environment in the spring of 1974 and in my twenty-five years of experience, it was the worst year which we had had experienced. In the Wall Street community itself, we saw many major investment firms begin to crumble. The amount of money which was being lost in the Street was significant and a lot of small firms just evaporated and went out of business.

This is a very important consideration to keep in mind when it comes to investing in any kind of sums.

In fact, there was serious concern as to whether the investment community's real function of raising capital for U.S. industry had been seriously, if not permanently, impaired.

That was the conditions which we faced in the spring of 1974 and we had been experiencing declining bond and stock markets the world over since late 1972, so that these declinings had been going on for at least eighteen months.

Q In those conditions which you described or, rather, how did those conditions which you described affect the exercise by an investment counselor, in the proper exercise by an investment counselor of his function with a client?

A. Well, it obviously had a very meaningful effect because none of us in practicing our profession prudently could foresee just what the future was likely to hold so that when counseling clients, advising them what to do with their money, not ours, the times screamed out to be defensive and absolutely careful.

Q. Well, turning then to, again, this group of debentures, all of which you have examined, did you find that all of them fitted into this category that you described as junk bonds?

A. Yes, they fit into that description.

Q. What characteristics were there in particular about those securities as you found them to be in the spring of 1974 which you regarded as making them unsuitable for the investment of the funds of the hypothetical client that I described to you?

A. The economic environment at the time was such that the degree of confidence that you had in investing on a long-term basis was such that you wanted to make sure that you were investing in only the largest or the strongest corporations because it was abundantly clear that one of the effects of the inflation taking place was what they called a liquidity crisis and that one of the effects of inflation is to increase substantially or significantly the cash needs of corporations so that it holds as virtually a truism that the largest corporations are the ones who will have the least problems in developing their cash needs, whereas the, quite often, the smallest companies are going to have a more difficult time in obtaining the lines of credits with their banks.

Q. Did any of these companies shown on the chart qualify, in your expert opinion, as large companies? I think we are dealing with a question of definition. Were they large or were they small? How were they regarded if you know?

A. I think they would basically be regarded as small or tertiary. We had --

Q. What was that word?

A. Tertiary or third-rate and we would -- maybe --

Q. Third-rate?

A. Yes. One maybe had the total sales volume of about $70 million. As I recall, the average may have been somewhere around $30 million in terms of gross volume.

Q. How does that compare with what you in your parlance were referring to as large corporations?

Let's at least get some dimensions so the people know what you are talking about. Let's take some of the ones that are better known.

American Telephone and Telegraph, do you have any idea what its gross is, approximately?

A. I think it's $12 billion.

THE COURT: Billion?

THE WITNESS: Billion.

Q. Or United States Steel?

A. I think that's about 4 billion.

Q. They are all companies with billions of dollars of earnings?

A. Of volume.

THE COURT: Not earnings, gross volume. Quite a difference.

Q. Now, what was there about -- you have described some of the background of it but with regard to these securities, what -- was there any general characteristic which they had which -- any other general characteristic they had other than the fact that they were small that made them unsuitable in your judgment for the hypothetical client?

A. For the most part, I would say that they were unseasoned and by that I meant they had not been in business a terribly long time. They may have been in business ten years or fifteen years or something of this sort. So that they had not reached a size where they might be felt to be able to meet the extraordinary economic environment that existed at that time.

Q. Do I understand that -- does that make them more risky if they are not seasoned?

A. Yes. One of the things that we look at in terms of investing is to how long has the company been in business. How it has prospered within that time and in some of these companies we found records of prior years, immediately prior years where they were running deficit operations so they had not been -- as a group these were not consistently profitable companies.

Q. In the course of preparing for your testimony today, did you yourself or through the assistance of others on your staff cause analyses to be made of each of these companies?

A. Yes, we did.

Q. Did you make any writings to prepare yourself for that?

A. Yes, I have some sheets.

Q. Do you have -- tell me some of the other things you did in reviewing these with regard to determining whether or not they were suitable for this $100,000 fund of the hypothetical client.

A. We had in terms of examination, we have a good library, research library and we had the occasion to make use of this as best we could. We referred to the standard statistical manuals as published by people like Moody's and Standard and Poor's. We referred to the annual reports which had been provided to us.

That essentially was our research source material for the individual companies.

Q. Did you make notes and records of these?

A. I so did.

Q. Did you bring them with you to the court?

A. Yes, they are in my briefcase.

MR. BLUM: May I offer them to the witness to assist him in his testimony as an expert?

THE COURT: Yes, I think you better cover the more mundane aspects of this that really have not been explained to the jury. Will you have the witness explain to the jury what a convertible debenture is and what is the importance of the fact that they may be subordinated convertible debentures.

Q. These were all convertible debentures, weren't they?

A. Yes.

Q. What does that mean?

A. All right. This is a debt instrument. It's a highbred debt instrument.

Q. What do you mean by "debt instrument"?

A. This is something which a company, in effect, is borrowing money. It sells these bonds to the public with the promise to pay back after a certain number of years and to pay a given rate of interest but they also put a wrinkle in with it to make it more palatable to sell because usually very often, either because of market conditions or because of the nature of the company itself, they don't want to sell common stock by itself or long-term debt by itself so they devised an instrument which at the option, generally at the option of the bondholder, debenture holder, he can convert into a specified number of common shares of that corporation.

Q. Does that have any effect on the market value of the debenture?

A. Oh, absolutely. The rise or fall of the underlying common stock will have an effect on the price movements of the bond itself and the bond market moves, the credit market moves will also have an effect on the volatility of the bond.

Q. Is it fair to state then that a risk factor in debentures which isn't present in standard bonds relates to the fact that they follow stock market movements?

A. Yes, they are generally more volatile than straight nonconvertible bonds.

Q. By "volatile" you mean they go back and forth and up and down more readily?

A. Yes.

Q. Let's turn to this term "subordinated."

What does that mean?

A. Subordinated, in effect, says it is the lowest rating of debt that a company has, that other creditors would rank ahead of it in the event of liquidation.

Q. What kind of creditors?

A. Banks, if you had loans out with banks. Or straight long-term mortgage debt instruments.

THE COURT: How about bonds, just ordinary bonds?

THE WITNESS: That's what I call a straight-debt instrument.

Q. Let's see if we understand it.

If there was a company that had straight bonds outstanding or a loan from a bank outstanding and it also had a subordinated debenture outstanding, and something went wrong with the company, they start cutting off the income from bottom to top, is that right?

A. The answer to that is academically generally correct, yes. There are exceptions. That is absolutely correct.

The convertible bondholder, when it comes to lining up to claim his money in the event of a liquidation, is normally at the end of the line as far as credit is secured.

THE COURT: Secured credit?

THE WITNESS: That's right, obviously secured credit.

Q. He comes ahead of the stockholder, is that right?

A. He comes ahead of the stockholder.

Q. But after all the bondholders?

A. That's right.

Q. And after the banks?

A. That's right.

THE COURT: And anyone else holding a security interest of another nature?

THE WITNESS: Correct.

Q. There was some mention here earlier about relation of company debt to company capital.

Did you examine each of these securities with regard to the relation between the company's debt and the company's capital?

A. Yes, we did.

Q. Why did you do that?

THE COURT: Before he gets into that and so we don't forget it, there never has been an explanation for the jury as to the importance of the over-the-counter market on the trading of these securities as opposed to listed companies and what effect that has on marketability.

MR. BLUM: Thank you, your Honor. It was on the list.

THE COURT: So long as you get to it at some point or another.

MR. BLUM: Let's get to it now since the Court has raised it.

Q. Mr. Rowney, where are these securities available when they are bought or sold?

A. The majority of them were traded in the over-the-counter markets. I think one or two were listed on the American Stock Exchange

Q. I'm talking about these convertible debentures.

A. Correct. That's right, they were over-the-counter.

Q. Over-the-counter is different from being traded on the stock exchange, is that correct?

A. That's correct.

Q. And to the investment counselor, what significance is there generally when there is a junk bond traded over-the-counter as compared to a security which is traded on an exchange?

MR. GOLDSTEIN: Your Honor, that question is not a really fair one unless he wants to compare junk bonds traded on the over-the-counter and junk bonds traded on the Exchange.

THE COURT: I agree.

Are there any junk bonds traded on the listed exchanges?

THE WITNESS: On the American Stock Exchange there are low-grade bonds which would be so-called junk bonds.

THE COURT: So let us confine ourselves first to the difference between being on a listed exchange and simply being over-the-counter.

Q. In corporations with regard to the stock or bonds or debentures generally of a corporation, let us assume two corporations of comparable size, one being traded over-the-counter and the other being traded on the New York Stock Exchange, does that have any significance to the hypothetical client that I described in the eyes of an investment counselor?

A. A listed security --

Q. Let's explain listed security.

A. A listed security is an issue which, in effect, is listed for trading purposes on a leading exchange such as the New York Stock Exchange.

The Stock Exchange requires of the companies whose issues are listed that it provide a certain minimum information or reporting to shareholders.

Those requirements were not the same for over-the-counter securities. In other words, a stock which is traded over-the-counter did not have to provide as much information to the Exchange, the Board of Governors for the Exchange, and to the general public as a listed security does.

In addition, the listed security implies or the purpose of a listed security is that a regular market of some fashion is going to be maintained on that security so that if you go to buy or sell it, you are at least assured that there is someone there who is going to try to do the trade.

Q. Now, with regard to these, which were over-the-counter, what was the market status when it came -- if it came to buying or selling them? The availability of customers?

A. Go back to listed again.

The brokers on the Exchange are acting just that way, as a broker or an agent. His purpose is to put Client A, who is a seller of security, with Client B, who is a buyer. And he earns a commission for putting these two people together. He has no -- generally he has no monetary interest himself in the particular security which is being exchanged.

In the over-the-counter markets it is different. In the over-the-counter markets you are dealing with a dealer who is acting, instead of as an agent, he is acting as a principal. He is putting up his own capital, say, to buy your security and, in turn, he is going to look to try to sell that to someone directly at a higher price and that spread is his profit and he is acting, however, as a principal rather than agent and he often carries an inventory if he is looking to sell securities which is financed with bank loans.

Q. Well, let's see if I can reduce that to a simple question.

Is it more difficult to find a buyer when you want to sell one of these than it is to find a buyer when you want to sell a bond that's traded on the New York Stock Exchange, other things being equal?

A. I think that's generally correct.

Q. Is it more difficult to find a buyer for one of these than it is to find a buyer for a bond of the highest -- the highest rated bonds traded on the New York Stock Exchange, be they bonds of the Telephone Company or bonds of Alcoa or what you will?

A. That was particularly true in the spring of 1974.

Q. True generally?

A. Absolutely.

Q. And particularly true in the spring of 1974?

A. Particularly true in 1974, spring.

Q. We were talking about debt to capital ratios.

THE COURT: Before you leave the question of the over-the-counter, do I understand that if a client goes to a person holding a brokerage license with no particular securities in mind and if this person is one who is in a company with a seat on the Exchange, he can, as agent, sell any of the stocks listed on that Exchange?

THE WITNESS: That is correct.

THE COURT: But if an investor goes to a broker who is solely in the over-the-counter market, unless he specifically requests something else, he is likely to receive only those securities in which the over-the-counter dealer is making a market?

THE WITNESS: That is certainly true of the smaller firms. If you went to a large firm such as Merrill Lynch, which is also a member, trades over-the-counter securities, a large number of securities.

THE COURT: I'm talking about one who does not hold a seat on the Exchange and is solely in the over-the-counter market.

THE WITNESS: That would be generally correct.

THE COURT: Which of course means that your range of selection is smaller and that the securities agent selling to you has a more personal interest in that which you buy than if you went to an Exchange broker who is selling you whatever you want?

THE WITNESS: That is correct.

THE COURT: All right. Continue.

Q. Pursuing that question just one step further, based on your experience in the investment business, is it customary for someone who is essentially a market-maker in over-the-counter securities to advise his customer or his client that that is what he is dealing in and that is what he is proposing?

MR. GOLDSTEIN: I object to that on the grounds it's leading, your Honor.

THE COURT: Rephrase your question.

Q. What is the customary practice of a market-maker in over-the-counter securities when consulted by a hypothetical client of the kind that I have described, if you know, in counseling as to the relation that he bears to the securities which he is recommending?

MR. GOLDSTEIN: Your Honor, I would object to that.

We have conceded Mr. Rowney's expertise in the area of investing but I have not heard yet that he is familiar with over-the-counter trading and familiar with what a market-maker in over-the-counter trading stock would or would not do.

THE COURT: All right.

Ask a few questions along that line to establish whether or not he is familiar with over-the-counter trading and the obligations of an over-the-counter trader to clients.

Q. Mr. Rowney, in the course of your some twenty-five years in this industry, have you had occasion to recommend any over-the-counter securities to accounts which you advise?

A. We have.

Q. Have you, yourself, had dealings with over-the-counter broker-dealers?

A. We have.

Q. And have you, yourself, on occasion discussed and become familiar with the practices of marketing securities in the over-the-counter markets?

A. Generally speaking.

Q Have you, yourself, -- are you, yourself, qualified and registered by having taken examinations with the New York Stock Exchange?

A. I am.

Q. Are you qualified and registered with the National Association of Securities dealers?

A. I am.

Q. Now I repeat the question.

MR. GOLDSTEIN: Your Honor, I still object.

He said he was generally familiar with over-the-counter trades. That does not qualify him as an expert.

THE COURT: Well, I think he has shown sufficient expertise to allow the question to be asked. If he has any doubts about his knowledge of the answer, he should express it.

Q. So I ask the question, what is the usual practice of a market-maker based on your general knowledge of the practice in counseling by over-the-counter market-makers with hypothetical clients of the sort I have described?

A. In other words, you are relating to his practices as it relates to the client?

Q. What's the accepted practice, if you know, on the part of a market-maker with respect to recommending purchases of over-the-counter securities in which he himself has an interest?

A. Well, just that. He must or should divulge to the client that he is acting as principal in the transaction.

Q. Let's turn --

THE COURT: By "principal" you mean the fact he is the owner of the securities he is selling to clients?

THE WITNESS: Yes. If he is not the owner of the securities, he would then or should advise that they would try to do the trade on a workout basis. In other words, he would try to find the security to buy and, in turn, would resell to the client but, again, acting as principal.

THE COURT: As a principal, does he receive a commission or does he receive a margin of profit based on something else?

THE WITNESS: No, he would receive a margin of profit.

In other words, when you looked at your brokerage confirmation which the brokers issue, there is usually a box there which shows for commission. If it's an over-the-counter trade, there will be no figure there and someplace on that confirmation it would divulge or should say that we acted as principal in this transaction and that to anyone who had any knowledge would mean that he is buying or selling for his own account.

THE COURT: What would determine the amount of profit he would make on the sale?

THE WITNESS: I'm not sure I am qualified to answer that, your Honor.

THE COURT: Don't guess with it if you are not sure.

THE WITNESS: No, I don't think I want to answer that.

Q. Now, in securities of these sorts, it says price per thousand here, 590.

A. Right.

Q. What we have heard -- we have seen slips of paper here which refer to prices of debentures of that sort as 59.

Can you explain to the jury the manner in which prices of bonds are quoted?

A. For example, 59 really means 59 percent.

Q. Of what?

A. Well, of the par value of the bond, so if the bond is issued in the thousand dollar denomination, 59 percent translates out to $590. If it was a hundred dollar denomination, 59 would be just like that, $59. Generally we look at it as a percent of the normal denomination for bonds, convertible or otherwise, which is a thousand dollars.

THE COURT: And that ultimate figure represents what will be paid at the maturity date sometime in the future?

THE WITNESS: That's right.

THE COURT: Obviously the longer the bond has to run before it's paid off, the lower the percentage will probably be. A bond that's a year away from maturing will be closer to 100 percent than a bond that's twenty years away from maturing?

THE WITNESS: That's absolutely correct.

Q. Well, pursuing that point, when a bond is as you have described less -- more difficult to sell, it's more difficult to find buyers for it and it's also many years away from its maturity, does that have an effect on the market price?

A. Yes, it does. It can cause wider spreads.

Q. What does that mean, a wider spread?

A. When you price over-the-counter securities, they are priced on what we call a bid and an asked basis. The bid is just that. The dealer is willing to bid for that security at such-and-such a price or he is willing to offer, sell to you that security at such-and-such a price.

On issues of this type and this size, relatively small, it would be commonly acceptable or you would see fairly above average volatility and uncertainty in terms of the bid and asked prices.

Q. Once again, volatility means what?

A. Lots of action up or down.

Q. Coming back to the debt to capital ratio, did you examine each of these companies with regard to the debt to capital ratio?

A. Yes, we did.

Q. Is the sheet you are examining a work sheet which was prepared by you or under your supervision?

A. That is correct.

Q. Have you examined the information contained in those sheets and are you satisfied that they are accurate?

A. I guess I am.

Q. Why is a debt to capital ratio a significant factor in your judgment in determining whether these securities are suitable?

MR. GOLDSTEIN: Your Honor, I object to the question. It assumes a fact not in evidence.

THE COURT: What fact?

MR. GOLDSTEIN: That it is significant.

MR. BLUM: I will withdraw the question.

Q. Was debt to capital ratio one of the factors which you examined?

A. We did.

Q. And was there a reason you examined it?

A. Yes.

Q. What was the reason you examined it?

A. The reason was that, again, in the spring of 1974 because of the extraordinary credit demands on corporations and the economic slide which had been underway and which seemed to be continuing, that we wanted to satisfy ourselves as to the credit worthiness of the corporations.

This went for all sizes of corporations because we were in an environment which was utterly unpredictable and which the threats of bankruptcy or reorganizations was really quite real.

Q What did you discover in your examination of the debt to capital ratios of these debentures at that time? First of all in a general sense did you find any common feature -- well, I'll withdraw that.

Was there anything that you observed in the debt to capital ratios of these corporations which affected your opinion that you, as an expert investment counselor, regarded these as unsuitable recommendations?

MR. GOLDSTEIN: Your Honor, I would ask that the witness qualify his answer with the statement that if he could jumble all of these into one answer or whether he has to answer about each one separately.

THE COURT: How is the question being asked, individually --

MR. BLUM: I am asking generally. I assume my colleague might wish to ask him individually on his own time but my question was put to him in a general sense.

THE COURT: I'll allow it. You can cross examine on the specifics if you wish.

MR. GOLDSTEIN: In that case, I would object to the form also, your Honor, because the witness might then be taking an average whereas one of these companies may be very good in capital and debt ratio, another one may be very bad. You average it together, you have a very low --

THE COURT: I am assuming he is not proceeding by average but by median. He is speaking of most of the companies and if most of them don't fall into a pattern, he can't answer the question.

Q. Is there some pattern there that you can detect or would you prefer that I ask it one by one?

A. I think we can fairly respond to the question in a general way.

These were corporations with a high, relatively high debt to capital ratio. In effect, what that meant was that -- it's like you or me having a mortgage on the house, a car to pay and a lot of other bills and what we were trying to assess was the ability, in the event of what might have been a depression, for these companies to survive.

So one factor, among others, was just to look at the general level of debt, considering that these were debt instruments. That prevailed on their balance sheets.

Q. Did you examine the status of the common stocks of each of these companies?

A. Yes, we did.

Q. Now, do the sheets that you have before you contain any of that information that you found, yes or no?

A. Yes, they do.

Q. Was there a reason that you examined into the common stocks of the companies which issued these convertible debentures?

A. Well, because these were instruments which converted into the common stock, it made sense to look at the underlying equity because that's the ultimate investment that an investor in this -- in a convertible looks for, looks towards.

THE COURT: Is the conversion at a fixed price or a variable price?

THE WITNESS: This is a fixed price subject to change because of stock dividends and other things.

THE COURT: I understand that, but if it was a fixed price in terms of the total number of stock outstanding at the time the debenture was issued?

THE WITNESS: Yes.

THE COURT: Consequently, the then existing market in the stock would indicate whether the debenture would be of any value in its convertibility factor when the time arrived, assuming that the stock price was then the same as it was at that time?

THE WITNESS: If I understand your Honor, the answer is yes, that we looked to see what was the premium that one paid for the convertibility feature, to have a play on the stock.

Q. Let me see if I understand that now.

Do you mean in order for the conversion feature of these convertible debentures to have value, you looked to see how much more you would have to pay, is that right, or what the difference -- or when you converted you looked to see how much more you would have paid than it would have cost you to go into the stock market and buy the same stock?

A. That's the answer.

Q. That's what you were looking at?

A. Right.

Q. And if you found that the premium, that is to say, what you would have to pay to convert got you stock at a price a great deal above what you found in the common market, then -- in the market for these securities for the common stock, how did that affect your judgment as to whether or not these were -- how would that affect your judgment as to whether these were a suitable investment?

A. Well, if the premium was large, in effect, meaning that the common stock would have to move up a considerable amount in price to justify the purchase of the bond, that obviously implied an additional type of risk.

Q. Now, with regard to Allegheny Beverage, what did you observe as to that feature?

A. I'm putting it -- the premium over conversion on the date that that bond was purchased, based on the offering price of the stock on that same date was in excess of 300 percent. In other words, the stock on that date in the spring of 1974, on that trade date, was selling at 1 5/8 and she paid $590 for the bond.

In effect, in order to make that, for the conversion feature of the bond to be worth anything, the stock had to move from 1 5/8 to about 5.

THE COURT: What was the fixed conversion price in the debenture?

THE WITNESS: The fixed conversion price on the debenture was $8.82 per share. That's really at par. Each $1,000 bond converted into 114.68 shares of common stock so if you take the 114.68, multiply it by 1 5/8 and compare that price with the $590, the difference is your premium --

Q. Is it fair to sum that up by saying that you discovered that the common stock had an awful long way to go before the conversion feature had any value, is that right?

A. Yes. And that was uniform in all of the bonds.

Q. Did you have any occasion to examine ratings of these debentures?

A. Yes, we did.

In the normal course of events, making use of the statistical manuals from the financial publishing concerns like Standard and Poor's and Moody's where there are ratings readily available, they publish them.

Q. Is it usual in the investment counseling business or with houses such as Drexel, Burnham or Merrill Lynch or others in your experience, to consult Moody's and Standard and Poor's with regard to these smaller companies when determining whether to recommend investments?

A. Yes. They become -- they are a common tool for an investment adviser to use because he can get an immediate inkling as to the size or the quality of the bond.

In all fairness, when we had looked at these, there were only a couple whose names were even familiar to us, to me.

Q. Now, does the rating of a convertible debenture have any affect upon the risk elements involved in owning it?

A. Oh, absolutely because the -- if you have a bond with a low rating, it's going to by that very nature a large part of the investment public is going to stand away from them. They are just not even going to bother with them so that you develop a greater market or price volatility factor, this question of price moves will generally be more volatile on lower grade bonds than they will on various highest grade securities of the same maturity.

Q. Now, are you familiar with the, generally familiar with the bond rating tables issued by Standard and Poor's and Moody's?

A. Yes.

Q. I show you this document and ask you if you -- if that's a copy of the bond rating descriptions of Standard and Poor's and Moody's.

A. Yes, this is.

Q. Now, let's have the rating once up.

Technical Operations there has a rating of CCC with Standard and Poor's.

Mr. Rowney, how many levels down is a CCC rating in the corporate bond ratings of Standard and Poor's?

A. That would be seventh down. Seventh from the premium.

THE COURT: How many ratings are there?

THE WITNESS: Nine.

THE COURT: And the higher you are, the better you are?

THE WITNESS: That's right. In other words, in terms of quality, Triple A is regarded as the best and Triple D would be the worst, anything with a Triple D is a bond in default.

Q. Would you read what it says there as a description of a CCC rated bond, please?

MR. GOLDSTEIN: Your Honor, I would object.

Mr. Rowney is here as an expert, not to read what a piece of paper says and I think we should call upon his expertise in saying what it means.

THE COURT: Well, it means what they say it means because it's a standard to be guided by and if they want to change their adjustments, they can do so.

Now, will you acknowledge, Mr. Goldstein, that this Moody's and Standard and Poor's are standard reference works for the investment industry?

MR. GOLDSTEIN: Yes, your Honor.

THE COURT: Tell us what it means within their denominations of meaning. Who are we dealing with now, Moody's or --

Q. Let's take a look at Standard and Poor's because Technical Operations says CCC and two others.

How do they describe CCC?

A. In my words or their words?

Q. Their words.

A. Bonds rated Triple C and Double C are outright speculations with the lower rating denoting the more speculative -- I guess there is a period there. Interest is paid but continuation is questionable in periods of poor trading conditions.

In the case of CC ratings, the bonds may be on an income basis and the payment may be small.

Q. I see there that Inflight and Arwood have a Standard and Poor's rating of B.

How many grades down is that, Mr. Rowney?

A. That's six grades down or one above the CCC rating.

Q. What do they say that they mean when they use B?

A. Bonds rated as low as B are speculative. Payment of interest cannot be assured under difficult economic conditions.

Q. Let's turn for a moment to Moody's. I believe there is a copy of the Moody's listings there.

That's familiar to you, you are familiar with that, aren't you?

A. Yes.

Q. Over there on the right on the chart, it shows that Inflight Services, Arwood, Allegheny Beverage and Elco had a B rating.

How many grades down in the Moody's rating system is B?

A. Six.

THE COURT: Out of how many?

THE WITNESS: Six out of nine.

Q. Can you tell us from observing on the following page how Moody's regards a B debenture?

A. Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of interest and principal payments or maintenance of other terms of the contract over any long period of time may be small.

Q. In connection with your analysis of these convertible debentures, Mr. Rowney, did you have occasion to examine into the earnings of these, the earnings records of the companies involved?

A. We did for the two years prior to the purchase.

Q. Well, what did you detect, if anything, in your examination of the earnings that bore upon your opinion as to the suitability or lack of suitability of this portfolio?

A. That the return on invested capital, what they earned on their assets, was small, and that the earnings records of some of the companies was erratic and by erratic you will find that you have profitability and deficit operations intermixed. In other words, they were not consistently profitable.

Q. You mean sometimes they were making money and sometimes they weren't?

A. That's right.

Q. Can you identify some of the companies which were either losing money or going through this erratic experience in their earnings?

A. Well, just going alphabetically here, Allegheny Beverage in 1972 reported a per share deficit, a deficit translating out in per shares of common stock of $3.12.

Q. Does that mean it was making money or losing money?

A. No, it was losing money. In 1972 they lost money. In 1973 they were back to making money of about 22 cents a share.

Q. Are there any others that you observed this feature in?

A. Well, in the case of Arwood Corporation, they were in deficit in 1972 and they were profitable in 1973.

Inflight Services was in deficit in 1972 and in 1973.

Q. That means they were losing money each year?

A. They were losing money. Losing money.

Q. Any others that you regarded as notable from the point of view of determining whether these were suitable at that time for this hypothetical client?

A. Any more companies?

Q. Any more of those where you found this piece of information, that is, the deficit, whether they were making money or losing money to be significant.

A. Right. Well, yes. Elco Corporation operated as a deficit in 1972 and was profitable in '73.

Knight Industries was in deficit in 1972 and was profitable in 1973.

And that was the group of those where we had the mixture of deficit -- profit and loss.

Q. Based on your experience as an investment adviser, can you conceive of any customer, any client to whom you would recommend that he or she put his entire investment fund into this group of convertible debentures?

A. I cannot.

Q. Do you regard that as a diversified set of holdings?

A. Not really.

Q. Why not?

A. Because numbers in itself don't mean -- don't imply diversification. You had a number of securities of generally all the same quality classification. They were low grade or junk bonds and that really isn't diversified.

MR. BLUM: Your Honor, if I may suggest I'm about to turn to a whole new set of questions with this witness. I am willing to go on, of course, but I ask whether your Honor wishes me to proceed.

THE COURT: How much longer do you expect to be with the witness?

MR. BLUM: At least a half hour. Maybe another hour.

THE COURT: We will adjourn at this time. The jury is admonished not to discuss the case.

(An adjournment was taken to October 29, 1976.)

BERNICE C. GRUPE

vs. 75 Civ. 2083

JOHN LAMULA INVESTORS, INC. and
JOHN J. LAMULA

October 29, 1976

(In open court; jury present.)

HARRY C. ROWNEY, resumed.

THE COURT: I remind the witness that he is still under oath.

THE WITNESS: I understand.

THE COURT: Continue.

DIRECT EXAMINATION CONTINUED

BY MR. BLUM:

Q Mr. Rowney, at one point, yesterday, you read to the jury a description of what the Standard & Poor's and Moody's guidebooks said with respect to the meanings of the categories B and C and CCC, but there are several on that chart which, I think, it is conceded, were marked "No rating."

Is "No rating" a designation which is familiar to you?

A It is, yes.

Q Can you tell me whether or not it is significant in the investment counselling provision, to give consideration to that rate in determining suitable recommendations?

A It is.

Q Would you read to the Judge and jury the description there of what "no rating" means. Let's take Moody's as an initial one.

A All right. It is entitled "Absence of Rating."

"Occasionally no rating is assigned or a rating is withdrawn or cancelled. This may occur if new circumstances arise, the effects of which are not satisfactorily analyzable, if there is no longer available reasonably up to date data to permit a judgment to be formed, if a bond is called for redemption, or for other reasons.

"Where no rating has been assigned or where a rating has been cancelled, that fact alone must not in any way be taken as a reflection on the quality of a bond.

"Where no rating has been assigned to a bond the reason could be one of the following:

"1. The bond belongs to a group of securities which are not rated as a matter of policy viz., real estate bonds, obligations of investment trusts and banks, and currently, bonds payable in currencies other than United States dollars.

"2. Where ratings have been requested for privately placed bond issues, such ratings will not be published."

Q If I may interrupt, what's a privately placed issue?

A That is an issue which is not sold publicly to a group of people. It may be selling to a group of people or a private group of investors.

"No ratings are assigned or may be maintained where public interest in any issue is minimal, or in any situation where it would be difficult to maintain constant scrutiny of the issue because of lack of essential data, or because of reduced size and limited after-marketability.

"3. Bonds are not rated in the absence of data deemed to be essential for a sound judgment on the investment quality of the issues."

Q In determining your answer to the question I asked you with respect to the hypothetical client yesterday, did you, in fact, give consideration to the "no rating" denominations here?

A We did, just as we did for the "specific rating."

Q How did that affect your determination with regard to those debentures which were listed as "no rating"?

A Well, in the case of -- well, with the exception of Lincoln Mortgage, we could understand where Moody's would not rate that, because it was their policy not to rate a real estate investment trust.

Q That's a real estate investment trust?

A Yes. In the case of the others, it was indicative they either could not get the information or they were of minimal size or of minimal interest so that they would not rate such issues.

Q Mr. Rowney, I want to return to my original hypothetical client and ask you -- you have the description which I gave you of that hypothetical client in mind, do you not?

A Yes.

Q Then without repeating that, let me ask you another question based on that hypothesis.

As an expert investment adviser, or an expert in investment counseling, what steps would you have taken or regarded as appropriate to take in the spring of 1974 in order properly to counsel this woman with respect to her investments? What would you have done?

A The normal procedure is to develop as much information as you can about the individual. We are interested in, obviously, you know, her age; we are interested in her earning capabilities; we are interested in what her total asset picture is; we are interested in her health; we are interested, again, particularly, with regard to age, as to what her retirement benefits she might have; we are interested in her dependencies; we are interested in whatever insurance she might have; we are interested in all of these things for the sole purpose of trying to understand or comprehend or make the client understand or comprehend what are the risks that that individual can afford to take.

Because when you are investing in any type of long-term securities, and that means bonds or stocks, you are making risk assumptions. You are going to be putting money out at risk, so that you have to have an understanding of the type of risk that the client can afford to take, because this is an unpredictable business.

Q When one is dealing with a hypothetical client, as I have described to you who is unsophisticated, does the investment adviser make any assumptions as to the client's ability to determine what's an appropriate risk in the design of an investment group of securities?

A Yes, he makes the assumption that the client really doesn't have the capability of making that judgment as to what risks that he or she can afford to take.

Q Having assembled those materials, or obtained that information, what's it in your experience -- what next is done? How does a counsellor go about doing it?

A Having determined the risks that the client can assume, we then kind of look at the broad brush environment in which he or she is investing. We touched on that at length yesterday, regarding what was the investing environment back in 1974. Without repeating all of that, we indicated it was a difficult and a horrendous environment, the most difficult since the early 1930's.

Q Let's focus on one aspect of our hypothetical client. You will recall that she had told you that she reckoned she needed about $12,000 a year to live on; that she had available investments of $100,000. How, in your experience, does an investment counsellor digest and act upon that information with that client?

A All right. We are given a certain asset picture, a financial picture of the client, and here we had a specific number in mind, that was approximately $100,000 which could be invested, for which there was, as I understand you, there was an interest in obtaining $12,000 income.

If we think that is realistic, then we can try to develop a program to try to achieve that. If we think the number is unrealistic, that the only way we could achieve that number would be to assume a commensurately larger risk, the client has to be told that, in saying that "Your objective is unrealistic, that what **we can do for you** is A, B, C, for which the return might be only $8,000, $5,000," or whatever conditions exist at the time and whatever her particular circumstances call for.

THE COURT: Let me ask him a question at this point.

Does it follow that with the convertible debenture where the convertible feature is badly under water, so much so that it has little value, little possibility that the stock is going to rise to the point of making the security aspect of it of any value, that depresses the market price of the convertible debenture, does it not?

THE WITNESS: That's correct.

THE COURT: If it is also speculative and poorly rated, that also will depress the price?

A It would have an effect on it, yes.

THE COURT: Now, these type of bonds, however, have a fixed interest rate, do they not?

A That is correct, yes.

THE COURT: Consequently, in dealing with these junk bonds, the return, the percentage of return that you are going to get is likely to be substantially higher than you would expect with a quality bond with a convertible feature of value?

A Right. You would be looking for the higher income to compensate for the risk, and the risk is really twofold here. The risk is maybe one in this particular case the conversion feature is worthless, because the stock is so far down, but the primary risk and the reason for the interest return is because you are concerned about the company's being able to meet its obligations over a long period of time. As indicated in the Moody's Ratings of yesterday, what they regarded as speculative.

THE COURT: In order to maximize income return you have to run risks?

A Correct.

THE COURT: If you had a client who said to you, "I must have a 12 percent return on my investment," after warning the client of the risks involved, is there any other safer investment you could have made to realize the 12 percent at the time we are talking about, than these so-called "junk bonds"?

THE WITNESS: There were other investment opportunities in higher grade straight non-convertible bonds where we could have achieved on balance somewhere between 11 and 12 percent. This was on essentially long-term utility issues, utility bonds. I am thinking, in the late spring and summer we saw a company like Consumers Power, which is a leading Michigan public utility which carries a Baa rating, which is fourth down on our scale, which covered a bond of $100,000,000 in size with an 11 percent coupon.

By the end of the summer, Duke Power, which is the leading North Carolina utility, also issued $100,000,000 worth of these -- were five-year notes actually, Baa rated, with a 13 percent coupon, so that there were other alternatives if the client was willing to assume some risk, or we felt some risk could be -- was justifiable, could have achieved very decent yields.

Obviously, the prime investment would have been the U.S. Government's, and in the spring of '74, late spring of '74, the prime investment U.S. Treasury bills -- these are like I.O.U.'s that the Government issues and which they pay back usually within 90 days -- were yielding about 8-3/4 percent, which to my recollection and analysis was the highest since the end of the Civil War.

Q Let's pursue that line of questioning that the Judge has opened, Mr. Rowney, this question of other investments. There is a kind of -- this was a time of great market turbulency, was it not?

A It was, indeed.

Q There is a kind of obligation known as "commercial paper," is there not?

A Yes, there is.

Q Is it a subject that you are familiar with?

A I am.

Q What's commercial paper?

A Commercial paper is a corporate I.O.U. The corporations are looking to raise funds to meet its day to day needs, really, have a couple of sources. You can go to the banks and borrow, for which it pays an interest rate, or the leading and the larger corporations have found that they can save money by issuing these I.O.U.'s directly to the public. Wall Street investment banking houses, in effect, market such securities.

Q In what unit do they sell them, as a rule, the better companies?

A Usually in denominations of $100,000.

Q In the spring of 1974 -- how long a term do they run?

A They come in various periods. You can get them -- I'd say again the typical one might be 90 days, but I have bought them for 30 days, 60, 120 days. Generally, less than a year.

Q Is it considered advisable, in times of market turbulence, when it is difficult to obtain secure investments, to acquire commercial paper over a period of turbulence?

A Absolutely. Certainly. Particularly with investors of size. They look at commercial paper and Government instruments.

Q What interest rate was prime commercial paper paying in the spring of 1974? Do you have materials which indicate that?

A I have some charts, if I can look at them.

Q Were these charts which you prepared, as you described yesterday, in the course of your analysis?

A No, these are really Xerox pictures of a chart book on all kinds of data that is published by the Federal Reserve Bank.

Q Were they part of the data you examined in preparing for your testimony here?

A Yes, they are.

Q With reference to those, then, what do you find that this prime commercial paper would have been available for for our hypothetical client in the spring of 1974, what yield?

A Prime commercial paper of four to six months' maturity in the spring of 1974 apparently peaked out, had a high interest rate of about 11.7 percent.

Q What are some of the companies, to your knowledge, Mr. Rowney, that issued prime commercial paper in the spring of 1974?

A Well --

MR. GOLDSTEIN: I would object, your Honor, on the following ground:

Mr. Rowney said, "up to 11.7." I think if Mr. Blum would expand his questions to say those questions in that 11.7 percent range, it would be more beneficial to everybody.

THE COURT: Yes.

MR. BLUM: If I may, your Honor, may I ask: Which companies, then, were issuing commercial paper at the higher interest ranges so far as you were aware at that time?

THE COURT: Give us the exact interest range, if you have it.

A Yes. I don't specifically know which companies were issuing in April or May. We know which companies are continually, generally, in the market and who the prime names are.

Q All right. Based upon your recollection and your experience as an investment adviser, which you were in 1974, as you are now, what do you recall to have been the companies which were offering their commercial paper, their prime commercial paper at maximum rates?

A I would say General Motors Acceptance Corporation would be one. They are continually borrowing. And Sears Roebuck Credit, which would be also another. These are prime names.

Q Again, turning to this topic of other investments, let us assume that the hypothetical investor that we talked about, or the hypothetical client, advised you that she was interested in the certainty of her income; that she advised you that her employment was insecure, and she advised you that she needed to be sure that the money would be there for her to live on; she advised you that she had a pension of some $2,000 which was the one certain piece of income that she had at the time and that she needed about $12,000 a year to live on.

Would there have been any duty on the part of the investment adviser, in your judgment, to recommend anything other than convertible subordinated debentures?

A I certainly would, yes.

Q Is there a duty on the part of the investment adviser, not just you, but is it your understanding, based on your experience in this industry, that the duties of the investment adviser are to consider and to discuss with the customer the possibility of different types of investments other than junk bonds?

A Absolutely.

Q In dealing with such a hypothetical customer, such a hypothetical client, would you regard yourself as -- would you, yourself, have regarded as suitable to disc with her for meeting her needs and satisfying and doing it within the risks that you had established?

A I missed your first word. Did you say "What was"?

Q What kinds? I am not asking specific names, but what other kinds of investments are there which, in your judgment, given this hypothetical client, were suitable to the risks that you felt it appropriate for her to assume and the income needs which she told you that she had?

A All right. Within the range of marketable securities, there were U.S. Government obligations, starting with that which was the most secure, regarded as the most secure; and from then we would go to -- **of different maturities, incidentally.** We could buy them 30 years long or a year long or five years long.

Then it would go in descending order in terms of high-grade corporate bonds, those issued by industrial corporations, utilities, which met the high-quality standards and where the yield at that time was also attractive.

There were also the alternatives of short-term investments, of just having money in savings accounts where the yields weren't up to par to the U.S. Government's at that time, but also implied considerable safety.

So there was a whole spectrum of investment mediums available to any client.

Q Were all of those which you have mentioned, investments of less risk than the convertible debentures which are listed on that chart?

A Yes, no question about it.

THE COURT: If you, as an investment counsellor, were responsible for a client, either buying utility bonds you spoke of earlier or the short-term commercial paper or the investment you have just described now, what would be your commission and what would be your recompense on the purchase?

A All right. As an investment adviser, we are paid a fee which is a percentage of the total value of the assets being supervised. Our income does not come from, you know, commissions as the result of security transactions. So that if a client came to us and agreed to pay for our services, if we said, "Put all your money into a savings bank, the $100,000, and our fee is going to be one-half of one percent," which is what we normally charge of the total assets, we would submit that bill that "This is what you owe us for that advice, one-half of one percent of the total assets."

THE COURT: Would there also be a commission payable to a broker on the purchase of utility bonds?

A Yes. There would be a transaction cost.

THE COURT: How much would that be percentage-wise?

A In terms of high-grade bonds, which are at a premium -- for example, if we were buying U.S. Government Bonds, the cost of that is like one-half a point. It is like, say, $5 per $100.

Q By one-half a point, you mean one-half of one percent?

A Yes.

THE COURT: $5 per $100 is 5 point.

A I am sorry, $5 per thousand.

THE COURT: Half-a-percent.

A Yes.

THE COURT: How about purchasing utilities like Duke Power and the other you mentioned? What would be the commission on that?

A The commission rate on that would be somewhat higher, but not perceptibly higher.

THE COURT: A percent or so?

A No, not that high at all. It would be less than that.

THE COURT: How about these commercial paper transactions? What commission is payable there?

A You really don't pay a commission on a commercial paper transaction because you are buying directly, say, from -- or even with an agent involved you are not going to see a commission. You are buying on a discounted basis. In other words, you buy in a commercial paper something that says $100,000, and the yield to you is going to come from the fact that you have paid $99,000, for example, and that when you turn it back in for redemption to be paid off, the difference between $99,000 and $100,000 is your earnings, your profit.

So that you, in doing that kind of transaction, are doing it on a net basis and you are not seeing -- you are making that calculation, if the yield at which you are buying is attractive to you.

THE COURT: I follow you. All right.

Q Mr. Rowney, is it usual in the investment advisory business, in your experience, when the investment adviser is dealing with an unsophisticated investor, to hand to him or her the annual report of the company whose securities are being considered and to read excerpts of that annual report to him or to her, to ask that person to review the annual statement and come back with any questions which he or she may have?

A No, sir, it is not.

Q Would you regard that, even if it is not usual, as an acceptable practice in counselling the unsophisticated hypothetical client that we have referred to?

A No, I would not.

Q Why is that?

A For a couple of reasons.

An annual report is really a kind of a self-serving document. A company is issuing its statement of its activities of the past year to its shareholders and it is looking to put its best foot forward. Someone has said that a balance sheet of financial statements are like a bikini. What it reveals is interesting, but what it conceals is vital. A sophisticated investor knows that what he has to do is not to accept what is being revealed, but try to dig deeper and to find out what is being concealed. So that is not an interesting task. That is not an interesting task for professionals. Because, normally, to the extent you are doing that, you don't want one annual report, you want a series of annual reports; and I specify "annual reports" and not just data within, as published in the financial services, over, year by year. So that, to turn these documents over to a client, an unsophisticated client, would only be for the purpose, in my judgment, to see what the company did in terms of its business endeavors.

It was a bottling company, or it was a real estate investment trust, and, you know, you could get a flavor of what the company's activity was, but it would not be that readily easy to the novice's eye as to what might be transpiring.

Q Did you, yourself, examine the annual reports of this particular group of bonds?

A Yes, I was provided with annual reports.

Q I provided these annual reports to you, is that correct?

A Correct.

Q In reaching the conclusion which you described earlier, as to the lack of suitability and the risk conditions relative to this portfolio, this group of securities that are mentioned on the placard, did you find anything -- examining these with your expert eye -- which were of significance in reaching that judgment?

A Well, the conclusion I came to, both separately and collectively, was that this was a group of securities which were riskier than this client could afford to take, particularly in the environment of 1974.

Q In engaging in that process, what features do you, as an experienced investment adviser, turn to in the annual reports? What do you look for?

A We approach this pretty simply, actually, because we were looking to -- we were looking for the obvious, first of all, without looking for what might be hidden. So the obvious place to start is to read the letter to the shareholders, which is normally written by the chiarman or the president.

Q I see, Mr. Rowney, in the course of your testifying, you are referring to some little scraps of paper.

A I have made some notes on cards.

Q Were those notes you made in the process of preparing your testimony for today?

A Yes.

Q Were they made by you in the course of viewing these documents and the other material you described?

A Yes.

Q Is it helpful to you, in order to recall what you were referring to, to have those before you?

A It would be, yes.

Q I am sorry. Please go ahead with what you were examining and what it disclosed to you?

A I was saying that we would start, first, with a letter to shareholders, and an annual report normally has pretty pictures to the financial data and a statement by the chief executive officer to the shareholders commenting on the prior year's activities. He will comment as to its success or lack of success, will often give a picture as to what they think the current outlook is, the outlook for the current year.

There were just some interesting things in some of the reports. Going alphabetically rather than the way you have them on the list, Allegheny Beverage, which is a Pepsi-Cola Bottler Co., 1973 did gross revenues of about $64,000,000, which is respectable or reasonably respectable.

Q What year was that?

A 1973, the prior year. This report was issued in April of 1974. But there were some interesting comments.

One of the things that we discovered here was that there was litigation brought against this company by the Securities and Exchange Commission, and to read from that paragraph relating to this from the chairman's letter, the chairman of the board's letter, to shareholders:

"The company's management should have been able to devote all its time and energy to operational matters in 1973, but found it necessary to divert attention and effort to litigation initiated by the Securities and Exchange Commission. Despite a strong and positive belief that the Commission's case is without merit, management believes that a serious attempt at settlement should be made in order to save the company and its stockholders from the extraordinary high cost in dollars and executive time this kind of litigation has forced upon the company. Several meetings between representatives of the company and the staff of the Commission have taken place in an attempt to reach a satisfactory settlement of the Commission's action. We have tried at all times to maintain a good working relationship with the Securities and Exchange Commission, consistent with the best interests of the company, its stockholders, debenture holders and employees."

Well, that kind of -- that couldn't necessarily mean the end of the world for the company, but kind of whets your interest.

The interesting part in most annual reports happens to be in the footnotes.

Q Footnotes to what?

A Footnotes to the financial statements. In other words, they will present numbers: the assets, liabilities, income statements; and then there are notes, footnotes, generally, to explain some of the numbers as they are presented.

In looking through the footnotes, we find Footnote 10, in this paragraph relating to the SEC, it expanded a little bit further. It said "May 11, 1973, the Securities and Exchange Commission commenced a civil action against ABC and 24 other defendants.". That was a subsidiary, including certain ABC officers. With respect to ABC, the complaint alleges, in substance: "ABC violated federal securities laws in connection with:

"One, the accounting treatment of revenues and income for sales of vending machines primarily in the year 1971; and,

"Two, a public offering of debentures by a subsidiary, in late 1971 and early 1972.

"The complaint seeks an injunction against future violations of the securities laws; and

"B, Amendments to certain reports, including financial statements previously filed with the Securities and Exchange Commission."

Q What light did that shed to you on the financial statements which were contained in that annual report?

A This is like the girl in the bikini. In other words, what's revealed is interesting; what's concealed becomes vital. And so we knew here that there was something going on without even going any place further. We could have gone to the Securities and Exchange Commission, for example, and got whole copies of the -- I guess the briefs, the documents speaking out the terms of the litigation. But, obviously, this raised a question as to the quality of earnings being reported. So that the numbers themselves may not be as helpful as we would like in assessing this company.

Q The conclusion that you have just described, that you reached as an expert, did that affect your judgment with respect to the suitability of Allegheny Beverage for the hypothetical client in the spring of 1974?

A Yes. That and the fact that it could, in terms of its earnings record, had been spotty or volatile, and that it had a deficit in its stockholder's equity.

Q Are those matters which, in your experience, an unsophisticated investor can readily detect from examining an annual report?

A Not really, no.

Q Without going through every single one of them, let's take two or three more and see. Why don't you pick from your notes, one or two where you thought there was some material particularly helpful to your evaluation?

THE COURT: Helpful plus not being obvious to the uneducated investor.

MR. BLUM: Yes, by all means.

A Let's take Knight Industries, which is on the board up there. This annual report was relatively sparse. This is not a large company. When I say "sparse," it's bare bones, and that doesn't mean it's, you know, a bad annual report per se.

Q What do you mean, "it wasn't a large company"? What were its gross earnings?

A In terms of its gross revenues in 1973, this company had gross revenues of $6,268,000.

THE COURT: What is the business of the company?

THE WITNESS: They are manufacturers of gas compressor units used in the oil and gas industry. In other words, it is called a "hardware business," making a heavy type of equipment.

There were two things in this annual report which were of interest. As I indicated, it was tied in with the oil and gas industry. Again, the letter to the shareholders by Dean Knight, the chairman of the board for the year 1973, and if you remember what I said yesterday, in the winter of 1973 we had an oil embargo and a quadrupling of oil prices, and no one knew what the outcome was likely to be from this.

To quote him from his annual report:

"The world-wide shortage of fuels and basic materials has had a profound effect on our industry. Natural gas, historically the cheapest of all fuels, is in increasing demand. A greater need for fuels and the corresponding rise in the prices of gas and oil have stimulated exploration and the reactivation of gas wells in previously marginal areas. These factors have greatly increased the demand for our products, and simultaneously made it more difficult for us to secure component parts. Although our backlog continues to increase substantially, presently exceeding 5.2 million dollars, shortages of essential materials and slippage in deliveries from our suppliers have caused corresponding delays and difficulties with our production schedules.

"Because of these difficulties, the first quarter of 1974 will be disappointing. We believe that most of these problems are being solved and that 1974 will show gratifying results."

Now, that is an obvious thing which you could pick up from the annual report. However, one of the other things that you will find at the end of an annual report is an accountant's report, and the accountants of the company, these are outside hired companies who do an audit, certified public accountants, attest as to the fact that these financials have been put together in keeping with commonly accepted accounting practices, and there has been a uniformity of procedure.

Q By "financials," what do you mean?

A I am talking about the balance sheet showing assets and liabilities of the corporation as well as its income statement: how much money it made, how much money it may have lost.

Now, reading from Peat, Marwick and Mitchell, which is a major accounting firm, one of the big eight, they indicate that they have examined the balance sheets and in accordance with generally accepted auditing standards. It says, however, "In our opinion, subject to the final outcome of the litigation described in Note 7" -- which means you have got to go and dig or find Note 7 -- "the aforementioned financial statements present fairly the financial position of Knight Industries."

In other words, subject to the final outcome of the litigation described in Note 7.

Well, Note 7 indicates that Knight had filed a suit against Worthington Corporation, which is a huge corporation. Sales are half-a-billion dollars; something like that. They had filed suit against Worthington to enforce the payment of an accounts receivable in the approximate amount of $50,000. That's money owed to Knight by Worthington.

"This receivable is included in trade receivable as a current asset in the accompanying balance sheet." This is also accounting kind of talk.

Q You are reading now from that footnote?

A Yes. "Worthington Corporation has admitted it owes approximately $16,000. However, it has filed a counterclaim against the company seeking recovery of approximately $600,000 for damages to certain compressor units fabricated in 1966 and 1967 by the company."

I will read the whole thing.

"The counterclaim asserts that the damages resulted from improper design or improper manufacture of the units by the company. The company has filed an answer in response to the Worthington Corporation counterclaim stating certain defenses. The case is expected to be heard during 1974. In connection with the counterclaim, the company's insurance carrier is defending the company. However, this is being done under a reservation or rights letter by the insurance carrier."

Basically, what that is saying is, "Yes, we recognize insurance liability here, but up to a point. We are not going to get stuck with this if we think there's been a real problem."

THE COURT: I think we should stop with that because that is not necessarily what the insurance company meant. There is another possibility; namely, that the insurance company had adequate insurance in force to cover the amount sued for, but, was not conceding that the loss was one within their policy. That is another possibility you have to take into account.

Q A possibility that if they lost on the counterclaim, the insurance company might resist paying off that debt so that the company would have to pay that debt?

A Yes, that is another possibility. You can't tell from that note exactly what the nature of the reservation is?

A That's absolutely right.

THE COURT: In either event, it is not happy news.

A It raises another question mark regarding the company with a total volume of around $6,000,000, as to its overall condition.

MR. GOLDSTEIN: Did you read the whole note?

THE WITNESS: No.

THE COURT: I interrupted him when he gave an interpretation I did not think was completely accurate.

A In reading the balance of the note:

"In the opinion of counsel, the company has a valid claim against Worthington Corporation for the account receivable and the matter will be heard during 1974. Accordingly, based on the opinion of counsel, the company has considered the account receivable as collectible and a current asset for purposes of determining compliance with the indenture requirement" --

Let's stop there. An indenture requirement is that document related to the issuance of debt, spelling out in effect the company's obligation.

"-- that the company and certain subsidiaries maintain current assets at a level at least equal to

200 percent of current liabilities. Without the inclusion of the account receivable in current assets, the company would not have been in compliance with this requirement."

And that's the line which Peat, Marwick is alerting you to when it says "subject to the final outcome of the litigation."

To finish the note:

"Without the inclusion of the account receivable in current assets, the company would not have been in compliance with this requirement. It is also the opinion of the counsel that the company has a meritorious defense to the Worthington Corporation counterclaim for damages. Therefore, the company has not made any provision for the Worthington Corporation counterclaim."

Well, I am not a lawyer, and I am not professing to judge or evaluate the merits of this case as briefly identified in the footnote, but in effect what you are saying is "Here's a little company up against a Goliath and they may be absolutely valid in their claim, but in the event that they are not, that the extent of that claim would seriously impact their balance sheet, so this is just another risk and it is the type of thing we would have said is not suitable as an investment except for someone willing to afford an extraordinary amount of risk."

Q Was that information, based on your experience, the kind of information an unsophisticated investor could determine by just examining the annual report?

A They would have to go into all the details of the report.

Q I don't want to prolong this through 11 of these, Mr. Rowney, but did you examine every one of these annual reports?

A Yes, we did.

Q After having examined each of these annual reports, was your conclusion unchanged that these debentures were not suitable in the spring of 1974 for our hypothetical client?

A To put it correctly, Mr. Blum, I came to the conclusion they were not suitable after an examination of the financials which included these annual reports.

Q Let me turn once again to our hypothetical client whose circumstances in the spring of 1974 you bear in mind, but let's alter the circumstances a bit hypothetically and let's now assume it is the last week of July 1974 or possibly the first few days of August 1974, and this time that same person hypothetically comes to you and she hands you a portfolio consisting of these junk bonds and she says, this is all she has in the world as an investment portfolio, and she doesn't have any cash reserves beyond it except a small amount in the bank in a savings account, two or three thousand or four or five thousand dollars in a savings account, and she hasn't got a job, although she has a teacher's retirement pension of $2,000 --

MR. GOLDSTEIN: I object to the point of four or five thousand dollars in the savings account. I think the testimony was, it was much higher than that, sort of $20,000.

THE COURT: It was until she gave some money to her son, and it isn't clear precisely when that occurred.

MR. BLUM: I believe the witness testified in the meantime she had ceased being employed in June of 1974, and she also testified that she had to go to her savings account for $4752 to cover the Elco, and that she paid $11,000 to her son, so I believe the testimony is in the record that the lady's account was at an extremely low level at that time.

MR. GOLDSTEIN: My recollection is that Mrs. Grupe got $138,000. $100,000 we know went into the C.D. There was 38 left. She gave 11 to her son. That leaves 27. Some, undefined, on various things. $4,000 for the stock. That still leaves between 15 and 20 -- let's be generous -- in the bank. There is no testimony it ever went below that point. There is no testimony it ever went below 27 less the money she paid for the other bonds.

MR. BLUM: That is incorrect. There was testimony it fell as low as $9,000 before she went into these transactions. There was testimony also that she went to her account for $2700 in June of 1974 in order to buy the -- to cover Mr. Lamula's purchase of the additional technical operations.

THE COURT: The only specific evidence I remember is a comment in a letter written in July to the effect, "Golly, honey, my savings account is getting low." As to how low, I don't recall. I will allow the hypothetical.

Q Again, returning to this hypothetical client who now comes to you at the end of July or the beginning of August and she says, "This is what I own," and let us assume that you review the investment quality of these at the time. What, in your opinion, was the investment quality of these securities for a woman with her capability for risk and her needs for certainty of income and her desire for safety of investment at the end of July 1974? What advice would you have given her at that time, with regard to the suitability of those securities?

A Our conclusion clearly would have been that these were unsuitable for a person of her circumstances and background to have between 80 and 100 percent of her total assets invested in, and we would have counselled that they should be disposed of.

Q In making that determination, was there anything relative to the economic climate at the end of July or the beginning of August 1974 which affects your recommendation, hypothetically?

A The stock market and the bond market were falling even faster than they were in the spring of 1974. Interest rates had continued to move up. There was no telling when they might be -- at that time, the emotional environment was even worse because of the Watergate involvement that summer, which led to President Nixon's resignation in August, as I recall it, so the atmosphere then was bleak, not only politically, but economically. There was just these very grave uncertainties.

Coming back to Moody's classification yesterday, or identification of certain types of bonds, the wording here -- I'm trying to be precise in this --"Payment of interest cannot be assured under difficult economic conditions."

Q What category is that?

A That was a B category.

Q What was the category just below that?

A "Bonds rated CCC and CC are outright speculation with the lower rating denoting the more speculative interest is paid, but continuation is questionable in periods of poor trade conditions."

Q Was that a period of poor trade conditions?

A That was a period of poor trade conditions, and so that considering this is not my money we are talking about, but someone else's money, it was clear to me that the only advice that could or should have been was to "Remove yourself from these securities." We had no idea whether they might have become worse thereafter, they might have improved thereafter; but there was just no way to know that, and what you have to do is to react to circumstances as they exist then.

Q In your judgment, would it have been an appropriate recommendation to this lady at that time to get rid of those junk bonds as quickly as she could find buyers for them?

A Yes, I think so.

Q Mr. Rowney, you have been in the investment advisory, in the securities industry now for 25 years, you have testified. Have you had occasion to know or become familiar with the firm of L.F. Rothschild and Company?

A Yes, I do.

Q Do you know whether or not that firm has experience in the handling of bond transactions?

A They have considerable experience in bond transactions.

Q Do you know whether or not there is any evaluation which has been made of L.F. Rothschild generally by the securities industry, which might be relevant to an understanding of the reputation of L. F. Rothschild?

A There is a publication, a trade publication out, which is called "The Institutional Investor." It's geared to fellows like myself who either work for banks, insurance companies or pension funds; and within the past year, they took a survey of institutions in the metropolitan area, meaning within a 50-mile radius, as to how those institutions ranked, the research capabilities -- firms of research departments, whose members spend time analyzing corporate balance sheets of companies or economic trends; and on the basis of this survey which they had taken this last spring, L. F. Rothschild was regarded by this group of people who were polled, as the No. 1 firm in research capability within the New York area.

Q Mr. Rowney, is the term "yellow sheet" familiar to you?

A Yes. There are actually two. There is one that relates to a Standard and Poor's data sheet on individual companies, and the other is having to do with a pricing sheet, a daily pricing sheet.

Q Let me read to you from a document which was admitted to be correct by Mr. Lamula's counsel in connection with this litigation, and ask you if this accords with your own understanding of the yellow sheets.

THE COURT: What are you reading from?

MR. BLUM: I am reading from a Request to Admit which was served on the firm of Baratta & Goldstein on April 23, 1976, Item 40. I make reference to defendants' answers to that document which was dated May 3, 1976, and which in Paragraph 1 admits each and every allegation in Item No. 40.

MR. GOLDSTEIN: Your Honor, since Mr. Rowney is an expert, I think proper procedure would be to ask him what the yellow sheets are, rather than reading something and asking him if it is correct.

MR. BLUM: I will try to short-cut the proceedings.

THE COURT: Read the admission and see if he agrees with it.

Q "The National Quotations Daily Service published by National Quotation Service with offices in Nassau Street, New York, issues each day a listing of bonds known throughout the industry as the 'yellow sheets.'" Is that correct?

A Yes.

Q "Each of the issues of convertible debentures which plaintiff acquired"--and here I am referring to this list --"from the defendants, was listed in the yellow sheets throughout May, June, July and August of 1974." Correct?

A Yes.

Q "The yellow sheets are commonly referred to by the public and persons in the securities industries for current information as to the name and telephone number of market makers, for any bond or debenture issue listed therein and as to the quotations of such market makers respecting such security for such day."

Is that correct?

A Correct.

Q I think that's as much as specifically pertains to this subject.

THE COURT: And by "quotations," you mean the price at which they are offering to sell and the price at which to buy?

THE WITNESS: Correct.

THE COURT: I take it the price at which they are offering to sell is always somewhat higher than the price at which they are willing to buy.

THE WITNESS: That is also correct.

Q Let me show you these and ask you if each of these documents can be identified by you as a copy of a yellow sheet.

A There is no way to tell the color as the result of the Xerox -

Q But you are familiar with -- you have examined yellow sheets on many occasions yourself, have you not?

A That is correct, and these certainly are the form.

Q This is the way they look and that's what they say?

A This is the way they look. They list the issue on the left-hand side, and then down the center are the names and telephone numbers of the firms who are the market makers, and on the right-hand side is the quotations and prices, if available.

THE COURT: What's the number on that?

MR. BLUM: They are 153, 154A, 154B, 156, 157, 158, 159, 160A, 160B, 161, and 162.

I am not sure they are specifically identified by those number in our pre-trial order, because some of these yellow sheets were assembled at different dates and times.

Each of these relates to the date of August 6 or 7, and there is one in October. They correspond to the dates on which L. F. Rothschild sold the debentures which are the subject matter of this litigation, and I offer these in evidence, preparatory to reading in the quotations.

MR. GOLDSTEIN: I would object and I would like to have a voir dire of this witness on this specific item, first.

THE COURT: Certainly. Go ahead.

VOIR DIRE EXAMINATION

BY MR. GOLDSTEIN:

Q Mr. Rowney, isn't it a fact that the figures quoted in there are the prices a market maker gives at, say, 10 o'clock on Thursday for the various securities mentioned --

MR. BLUM: Objection. This is not a voir dire; this is in the nature of an impermissible cross-examination of a witness who has not been offered as an expert on the subject of these yellow sheets. He has been asked only if he can identify the accuracy of the information and identify these as copies of yellow sheets. The yellow sheets themselves, as I understand the law, are admissible under 803.17 of the Federal Rules of Evidence without the necessity of being read by Mr. Rowney; they could be read by me. I do not proffer this witness as an expert on the market-making procedures. I offer him as -- I have offered him as his evidence has indicated, as an expert on investment-advising, on the suitability of securities.

MR. GOLDSTEIN: Your Honor, Mr. Blum yesterday questioned Mr. Rowney on market-making procedures of small companies and qualified him as an expert.

MR. BLUM: I did not.

THE COURT: Stop. Stop. Gentlemen.

MR. BLUM: The Judge asked those questions.

THE COURT: The issue is whether or not the questions you are asking him go to the admissibility of the document or the weight to be afforded to it?

MR. GOLDSTEIN: No, the admissibility.

THE COURT: He is suggesting it only goes to the weight, not to admissibility, and consequently it is improper voir dire.

MR. GOLDSTEIN: I am going towards admissibility, your Honor.

THE COURT: In what respect?

MR. GOLDSTEIN: Because I intend showing, through Mr. Rowney's testimony, that the figures quoted in here are at best speculative, subject to change, and really only reflect the fact that XYZ Brokerage house is a market maker in those securities, with very little else; and, therefore, to introduce these into evidence with figures showing what they intend to sell these securities at, would be grossly prejudicial.

THE COURT: How do you square that with the second Circuit's holding in Merritt, Vickers, Incorporated v. SEC?

MR. GOLDSTEIN: I have not had a chance to look at that case so I can't give any comment on it.

THE COURT: How about Charles Hughes & Company v. SEC?

MR. GOLDSTEIN: The same thing. Mr. Blum handed me that supplemental brief this morning.

MR. BLUM: The issues were described in the pre-trial memorandum. Each of these cases was not only cited in this, but in our trial memorandum which was handed to Mr. Goldstein several days ago.

THE COURT: Those cases would indicate the yellow sheets are prima facie evidence of prices as of the time they are issued, and therefore admissible. As to whether or not they are controlling and as to what other evidence you might wish to adduce, you may do that on cross-examination.

MR. BLUM: I offer them in evidence then, your Honor.

THE COURT: Any other objection besides the one already stated?

MR. GOLDSTEIN: No, that would be the basic objection, your Honor, to show that they are not fair indications of any price.

THE COURT: They are evidence albeit they are not conclusive. They will be admitted in evidence.

xx (Plaintiff's Exhibits 153, 154A, 154B, 155, 156, 157, 158, 159, 160A, 160B, 161, 162 and 163 for identification received in evidence.)

DIRECT EXAMINATION CONTINUED

BY MR. BLUM:

Q Now, Mr. Rowney, you will need your reading glasses for these because the print is rather small. I think they run in the order of -- let me put up one of these placards, because it may be easier for the Court and jury to follow. They are arranged in this order.

Would you read the listings shown on those dates for Allegheny Beverage Corporation on August 8, I think? Excuse me one moment.

MR. GOLDSTEIN: Your Honor, I think one point should be cleared up, without going into admissibility, if we can approach the bench on this.

THE COURT: If you are going to point out, you can't tell a thing from that chart without knowing how many shares are involved and the chart doesn't show you --

MR. GOLDSTEIN: That is not the point.

THE COURT: All right.

(At the bench.)

MR. GOLDSTEIN: My point, which I was trying to bring out on admissibility, but still is a valid point is this: That the price of, say, the price at which the broker is going to sell the securities today, was put in the yellow sheets yesterday, the price in the yellow sheets today, is not indicative of the price being sold today.

THE COURT: To completely cover the yellow sheet problem, you should put in the quote of the morning before the purchase and the quote of the morning after, which I don't know if that's been done or not, but it does not mean that the quote as of the morning has no evidentiary value; it merely affects its weight.

MR. GOLDSTEIN: What I am saying is, if Mr. Blum asks him to read something in the yellow sheets on the day the security was sold, it should be pointed out that is not necessarily the price at which the securities were being sold that date.

MR. BLUM: I think that is incorrect. My understanding -- and I believe it is admitted. I will go back to the admissions, if you want -- I believe it is in our requests to admit, the quotes are collected on the day indicated in the sheets. The sheets normally reach people the following day, but the point is they show the quote that was made by the market maker there on the day on which those trades took place, even though they didn't reach the client until the day after; and therefore, they are the best evidence, subject to anything else being offered.

MR. GOLDSTEIN: If they don't reach anybody until the day after, what sense do they make?

MR. BLUM: They show the market price on that day.

THE COURT: I have heard enough. Let's go.

(In open court.)

Q Let me ask you, before you commence reading, Mr. Rowney, one question. Where prices are shown there, they give them as of bid prices and ask prices; is that right?

A Yes.

Q So if one is looking to sell a debenture, one is most interested not in what the person is quoted the market maker is offering to sell them to you for, but rather, is bid a price which is what he will pay you for them?

A That is correct.

Q So that after you read each one of these, I will read the price indicated on the L. F. Rothschild confirmation slips on these transactions.

Would you read what it says with regard to Allegheny?

A It's Allegheny Beverage, the 6-1/4 debentures due 1988.

MR. GOLDSTEIN: Excuse me. What day are we reading on?

Q What's the date at the top of the sheet? The top or the bottom.

A In the middle of the sheet --

Q No, that's the certification note from the company?

A I am sorry?

Q The date of the sheet is at the top or bottom?

A It is August 6, 1974.

THE COURT: Were you merely attempting to establish, the prices at which Rothschild sold these debentures in August and one of them in October,were the prices which were listed in the yellow sheets at that time?

MR. BLUM: They were the going market prices at that time. Yes. We want to prove they sold them at the market and not under the market.

THE COURT: Is that really in issue here, Mr. Goldstein?

MR. BLUM: I believe it's been put in issue. If you will concede they sold them at the market prices --

MR. GOLDSTEIN: That is at issue.

THE COURT: You claim they sold at less than the market prices.

MR. GOLDSTEIN: Our contention is, they may have sold at less, or at the very best, they sold it at the lowest market prices they could get. In other words, although they called up maybe one broker and whatever he gave they sold, rather than trying to get the best buy.

THE COURT: That's a different point from whether or not the prices they sold at are those listed as the bid prices in the yellow sheets.

That is mathematical. You compare one set of exhibits with the others. Do you contend, having done that, you find discrepancies?

MR. GOLDSTEIN: No.

THE COURT: Then what are we wasting our time on? His point apparently is going to be: they could have gotten better prices than what appear in the yellow sheets of that day.

MR. BLUM: If counsel will stipulate that the prices at which L. F. Rothschild sold are reflected by the bid prices in the yellow sheets for the day in question, that's all I want of this reading.

MR. GOLDSTEIN: Are reflected in the sense that they may have been on the low side, but I will concede that.

THE COURT: When you say "low side," what do you mean?

Let me look at the yellow sheets. Let's take one example.

(At the bench.)

THE COURT: These are hard to read. These are rotten copies.

MR. BLUM: I asked if they could bring the books themselves. They couldn't. They bind them in fat volumes. You would have to carry a fat volume for each one, which is an impossible job.

THE COURT: Which one appears on this page? Which is more legible than the other?

MR. BLUM: D.W.G. Corporation down at the bottom.

THE COURT: For D.W.G. there are two prices listed, but they refer to different debentures. Are we dealing with those maturing in '87 or those in '94?

MR. BLUM: '94.

THE COURT: There was obviously a single price listed there: 45.

MR. BLUM: This is 41.

THE COURT: Then you are below the price.

MR. BLUM: Let's go on with others.

THE COURT: Here's Arwood --

MR. BLUM: Some of the D.W.G. were sold at 43 and 5,000 sold at 44.

MR. GOLDSTEIN: The quote was 45.

THE COURT: Inflight lists two asked prices: one from Wechsler & Krumholz of 25, and one of Lamula of 22.

MR. BLUM: This one was sold at 24.

I have tracked every one of them and they are all within the range.

MR. GOLDSTEIN: The only thing I could concede is that the prices sold in some cases were below those cases sold; and in many, were the same.

THE COURT: Are we dealing with the Nortek 88 or 89?

MR. BLUM: 88.

THE COURT: Only one asked on that, Kidder Peabody 44. What were they sold at?

MR. BLUM: 41.

THE COURT: Go on back.

(In open court.)

THE COURT: It makes no sense whatever to go over each of these things separately, comparing the price in the yellow sheet with the price sold. Can we not get up a schedule which shows the comparison of the two?

I should tell the jury they are going to find two confusing aspects of this: One is that the market makers do not all publish the same price, and one market maker will be offering a different price from another one, so you have got a range right there. The second slightly confusing aspect is that with sales on the same day, they are not all at the same price. The price can range slightly, up and down, which I think makes sense to you. As something goes on the market, the more of it that becomes available, the price tends to drop. And/or factors affect upward and downward movement of price even in a given day.

Will you gentlemen agree to get up a diagram showing all of the prices on that particular day which anybody asked, and all of the prices actually obtained by Rothschild on that same day?

MR. BLUM: You want a chart that reflects every bid and asked shown in the sheets?

THE COURT: I don't know why we have to include bid and asked, because we are selling, not buying. Every bid.

MR. BLUM: Every bid reflected in the sheets on those days and the price at which L. F. Rothschild sold?

THE COURT: Yes, and I think if Mr. Lamula's company is one of the makers and has a bid price in, that should be reflected. If he is not the bidder, it is not important.

MR. BLUM: The name is not important if it's not Lamula; but if it's Lamula, I agree, it's important.

THE COURT: Can you do it that way and save us endless time.

MR. GOLDSTEIN: The asked price would become important later?

MR. BLUM: Since I assume my office will be stuck with the task of having to put it together.

MR. GOLDSTEIN: For that, we would have to approach the bench again.

THE COURT: Let's talk about it later.

MR. BLUM: I certainly will be happy to get up such a chart, whichever way the Court decides it should be.

THE COURT: Rather than comparing numbers, I think it would be appropriate to extract a little testimony from the witness, explaining the fluctuations on a given day and the difference between prices between different market makers and why this is.

MR. BLUM: I will ask him some questions, but, again, I note, while I have not qualified him beyond generally as an expert with regard to this process, still in accordance with Rule 702 of the Federal Rules, I think it may be helpful and, therefore, with that qualification, I will ask these questions.

THE COURT: I don't think this is a tremendously esoteric area. I think, virtually everybody in the investment business understands this aspect of it.

Q These were thin market bonds, is that correct?

A Yes.

Q What does "thin market" mean to you?

A The activity in them, the volume being traded, tends to be on the light side; not substantial.

Q And based on your general experience in price fluctuations, in thin market securities, over the counter, when someone determines to sell a number of them for whatever reason, in a hurry, can that have the effect of resulting from time to time in sales below the bid prices quoted by market makers?

MR. GOLDSTEIN: Your Honor, I would object to that unless he is qualified as an expert. I think that is more than being just esoteric.

THE COURT: I don't think that is a very technical aspect. I know the answer to that myself. I will let him testify on it.

A All right. The figures which are being shown here, these bid-and-ask quotations, are obviously the figures which existed at a certain precise time. On thin market stocks, the thinner they are, as a general rule, the more volatile they can be; and by "volatile," as we discussed yesterday, the price ranges can widen.

Q And by "thin," you mean fewer buyers?

A Buyers and sellers or general inactivity or the amounts outstanding, the total float of the stock or bond is small. It would generally be called "thin markets," not active markets. So that when a buyer or seller comes into a thin market security, he doesn't necessarily have to buy in large quantities to distort the price or to change the price relatively quickly.

Q Is the same true in selling?

A Yes. On both sides. Remember that the buyer or the seller of these securities, the dealers, are putting up their own capital here, so that they are very, very keen as to how they are going to bid or how they are going to offer stocks or bonds.

Q Leaving the area of your general expertise and returning to the area of your more detailed expertise, and specifically, the advice that you regarded as appropriate for our hypothetical client in the beginning of August 1974, would you, even with the general knowledge that you have testified to, under the economic conditions which obtained at the beginning of August 1974, have recommended that the bonds and the debentures in question be disposed of as quickly as possible?

A Yes.

Q Why?

A Because there was always the risk that they could be at lower prices. In fact, there was considerable risk they could be at lower prices sometime in the future.

THE COURT: Were there additional risks such as the company failing and the bonds becoming virtually worthless?

THE WITNESS: The answer to that is clearly yes.

Q Let's turn to our last area, for your specific rather than your general expertise, Mr. Rowney. Have you had occasion, in preparation for your testimony, to review these debentures, and to review the movements in the market, in the securities market generally, between the spring or summer of 1974 and this date?

First of all, with regard to these.

A The answer to the question is that I did not review the price fluctuations of these specific securities, after the acquisition dates, that were in question, in these particular three months.

In terms of "general," we knew exactly what in general was happening to the general market in that time.

Q Was there a reason that you didn't examine into the fluctuation in the prices of these debentures between the spring or summer of 1974 and now, in deciding whether they were a suitable investment for the hypothetical client in the spring of 1974?

A No. It just didn't enter my mind that that was a consideration at all.

Q Why was that? Let me put it this way. Is there any factor that you can perceive now, in the fall of 1976, which leads you to believe that this convertible, that any of these convertible debentures was in fact a suitable investment for our hypothetical client, in the spring of 1974?

A No, I would not have changed -- I would not change my mind now as compared with, say, the hypothetical case, in the spring of 1974. In other words, what I am saying is that these securities are still -- there is a problem here, Mr. Blum, as you know, that some you couldn't acquire now; they don't exist.

Q Why is that?

A One of them went in bankruptcy and two of them have been merged out, and another is marketable but is in the threat of bankruptcy.

THE COURT: I think we ought to explain to the jury, though, this is a matter of hindsight and that in terms of what appeared appropriate at the time, you had to deal with the information then available. The fact that several of these companies may have in fact done extremely poorly is hindsight, just as the fact that some of them may have come out quite well is also hindsight, and that an investment counsellor or that an investment adviser has to act on the information then available.

Is that correct?

THE WITNESS: That is exactly right. We tried very hard to avoid the benefits of hindsight. We took the information that would have been available to us in 1974, meaning the manuals, the statistical manuals we looked at, those which were available from our library, pertaining to that particular time, and in terms of looking at the market environment at the time, as to what were the conditions that we would have been faced with had we been approached with this hypothetical client, so that we really did not look beyond.

MR. BLUM: I have no further questions for this witness at this time.

THE COURT: All right. We will take a brief recess before we proceed with cross-examination.

(Recess.)

(In open court; jury present.)

THE COURT: You may proceed.

CROSS-EXAMINATION

BY MR. GOLDSTEIN:

Q Mr. Rowney, there are basically three exchanges in the metropolitan New York area: the New York, the over-the-counter, and the American; isn't that correct?

A That's correct.

Q And, of course, all over the country there are a lot of other exchanges?

A That's correct.

Q Where are most securities traded?

A Most securities are traded in the unlisted markets, in the over-the-counter markets.

THE COURT: By "most," do you mean in terms of total volumes of shares or in terms of total numbers of companies?

MR. GOLDSTEIN: Total number of companies.

THE WITNESS: Yes.

THE COURT: Would your answer be the same if you were dealing with total number of transactions?

THE WITNESS: The answer to that would also be yes, because just the value of Government securities alone which are traded --

THE COURT: Take the Government securities out of it.

THE WITNESS: Yes, I would say that would be a correct statement.

Q His Honor anticipated my next question.

Isn't it a fact that Government securities are traded on the over-the-counter market?

A Yes.

Q Isn't it a fact that banks are traded on the over-the-counter market.

A Banks?

Q Banks, obligations of banks.

A You mean debt obligations of banks?

Q Some obligations of banks, be it debt or otherwise.

A What are "otherwise"?

Q Are there any obligations of banks traded on the over-the-counter market?

A Yes, there are, and there are listed, also.

Q What about insurance companies?

A Insurance companies trade both over-the-counter and on listed exchanges.

Q But some of the biggest companies are traded on the over-the-counter market?

A That is correct.

Q In other words, there is nothing inherently unsavory about saying the stock is traded on the over-the-counter market?

A No.

Q It is a well-respected exchange?

A It is a well-respected method of exchanging securities.

Q That's correct.

Now, the term "market maker" has been mentioned. Do you know what the definition of a market maker is?

A Yes, I do.

Q What is it?

A In the over-the-counter markets, it refers to a firm which indicates its interest in a willingness to trade in a specific security, and it advertises that fact in the type of sheets which were offered in evidence before.

Q Is it true that market makers are an integral and important part of the over-the-counter market?

A Certainly.

Q Isn't it a fact, without market makers, you really would not know where to buy or sell certain securities traded on the over-the-counter market?

A Yes. You would have to refer to the advertising.

Q That's correct.

Now, what are specialists, as applied to the New York and American exchanges?

A A specialist is a member of the exchange, whose function is to try to maintain an orderly market in a given security or group of securities.

Q For instance, if I want to sell AT&T stock, I go to my broker, he calls somebody on the floor who knows, is that correct, on the floor of the exchange?

A Right.

Q Do they then go to the specialist to buy or sell the AT&T?

A They go to the man maintaining the book on the stock, whose function is to match buyers and sellers, who would be known as the "specialist."

Q Convertible debentures are debentures which can be converted into stock for a certain price, is that correct?

A Correct.

Q And they also pay interest?

A That is correct.

Q What's a warrant?

A A warrant is a piece of paper which entitles the owner of that piece of paper to exchange it, plus issue some cash, for a stock at a predetermined price.

Q Is interest paid on any warrants?

A No. No interest is paid.

Q Do warrants have an expiration date?

A They can have an expiration date and there are some which are perpetual.

Q Where there is an expiration date, what happens when that expiration date comes around?

A In the case of an expiration date in a warrant, that warrant begins to lose its value, so that on the date of the expiration date, theoretically, it would be valueless, unless it was exercised.

Q If it wasn't exercised the day after, it's worth nothing?

A That's correct.

Q You can't go to the company and say, "Buy back my warrant"?

A No.

Q What about a convertible debenture? What happens on the expiration date, assuming the company is still in business?

A Assuming the company is still in business, the debenture, the bonds, would look to be -- would be paid off.

Q By the company?

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Q Take a thousand dollar debenture which, say, was purchased at $490 or something. The expiration date is now here. You go to the company and present your debenture. What price does the company give you?

A The requirement under the bond in tenure is to pay the face value of the bond.

Q A thousand dollars?

A Yes.

Q So, in effect, if you bought it for 490, you would make $510?

A That's correct.

Q It would not be worthless on the date it expired, again assuming the company was in a position to pay it off?

A That would be correct.

Q Did American Telephone and Telegram issue warrants?

A American Tel did issue warrants a few years ago.

Q Did those have an expiration date?

A They did have an expiration date, yes.

Q So when that expiration date comes around, if you had bought those, say you had bought $10,000 worth of

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Q So when that expiration date comes around, if you had bought those, say you had bought $10,000 worth of warrants and hadn't exercised it, the day after expiration you would have worthless pieces of paper?

A That's correct.

THE COURT: Mr. Goldstein, what have warrants got to do with this? This is the first mention I have heard of warrants. The plaintiff didn't purchase warrants at any time in this matter, did she?

MR. GOLDSTEIN: No, your Honor, but the intimation given by counsel for plaintiff is that there is something sinister about convertible debentures and subordinate convertible debentures and I want to point out, there are other securities, just as Mr. Blum mentioned there are other securities, that perhaps aren't as good and perhaps are issued by companies which are in a much better financial position than these companies.

THE COURT: I mean, if you are comparing apples and oranges, you are not making a fair comparison. A warrant is not a security. I take that back. We have a case pending in this court right now, where it's contended that warrants are securities and therefore everybody who has been dealing in them has been doing it illegally, but until such time as somebody agrees with that argument, they are not securities any more than tickets in the New York Lottery are securities, so let's stop comparing things that have no comparable ratings.

Q Mr. Rowney, somebody buys a convertible debenture. While it is true that the debenture could be converted into -- well, strike that.

The convertible debenture provides that it is converted into stock at a certain price?

A Correct.

Q How does that work, specifically?

A Generally, what is done is that the bond issued and the conversion feature is often spelled out in terms of number of shares. In other words, the holder of the bond is entitled to exchange that bond for X number of shares. It might be 20.72 shares of stock.

They work it in price, and you relate the price to number of shares.

Q Do you have to pay extra for those shares?

A Do you have to pay extra?

Q In other words, if you have a convertible debenture and you want it converted into stock, do you have to pay additional money for the privilege of converting it?

A Generally not, no.

Q Do you know of any convertible debentures which were ever converted into stock?

A Is that the question?

Q Yes.

A Sure.

Q What would be the reason for converting it?

A The reason for converting it. Because the conversion feature had become valuable. The price of the underlying stock had risen sufficiently in price so that if you took the number of shares to which you were entitled, multiplied it by that market price, it extended out to a value greater than you paid for the bond or what the bond would be worth at redemption.

Q Somebody buying, say, Allegheny, at $590 per thousand, what would you think would be their reason for buying that convertible debenture?

A (No response.)

Q Let me strike that.

Would the reason for buying the Allegheny Beverage convertible debenture, the hope that you could convert it into the stock, would that be the primary reason that you would buy it?

A If we are talking about that specific debenture on that specific date, we are talking about a debenture where the premium over conversion was some 300 percent, which means that the stock would have to move up considerably in price to just have that premium, so that the reason for buying that particular issue at that time would not be for the immediate conversion attraction because in my judgment there was none.

Q What would be the reason for buying it, then?

A I think there would be two reasons:

One, if you were a trader inclined to trade securities, one, there are people who actively trade these because of the situation which can take place in them. Rather than trade stocks, they trade these junk bonds.

The other reason is that you were going to forget them for the next ten years or whatever it is and hope or anticipate they would be paid off at par value, at the $1,000.

Q You say "forget them." In other words, if you left them for ten years and then you came to Allegheny, you would make $410 on each bond?

A That's the whole, theoretically, idea, yes.

Q During those ten years, what other benefits would you be getting?

A You would have gotten the interest on the debentures.

Q How much interest?

A In this one, they were paying -- that was a

6-1/4 percent debenture.

Q How much interest were they paying, though, in actual amount?

MR. BLUM. Per what?

Q Somebody who bought --

MR. BLUM: I object to the form of the question.

MR. GOLDSTEIN: I will change the question.

Q Somebody who bought a thousand shares at $590, how much return on their money were they getting?

MR. BLUM: You don't mean "a thousand shares; you mean "one bond with a denomination of a thousand dollars"?

MR. GOLDSTEIN: That's correct.

THE COURT: When?

MR. GOLDSTEIN: At this point.

THE COURT: Starting then and running thereafter.

Q Right, on May 3rd, if you would buy the $1,000 bond for $590, and then subsequently start getting interest, and let's assume the price stayed exactly the same at $590, what would be your return on that on an annual basis?

THE COURT: Counsellor, I don't think the return has anything to do with the bought price. I think the interest is payable as against the face price, is it not?

THE WITNESS: Yes, sir; that's correct.

Q But the fact is, it is paid on the face amount, a thousand dollars?

A Correct.

Q But in actuality, you have paid 590?

A Yes.

Q You have invested 590?

A Yes.

Q What's your annual return on $590, based upon the interest they are paying?

A 10.6 percent current return.

Q There was some discussion yesterday about bonds and triple A bonds, double A bonds. Isn't it a fact that all bonds are subordinate to bank loans?

A Yes, I think that's correct.

Q In other words, if General Motors issued a bond, it would still be subordinated to any bank loans General Motors would make?

A Yes.

Q What's the collateral for a bond issue?

A It used to be that it was a mortgage just like you would have a mortgage on your house against a specific piece of property. There are still --

Q Excuse me, when you say "used to be," when was that?

A I am going back into the history of bonds. They were issued initially as mortgages, that someone had a lien on a specific piece of property, a railroad car, a factory, or the total assets involved.

Q Go ahead.

A I have answered your question.

Q What were they in 1974?

A There were still mortgage bonds around, but these are not mortgage bonds.

Q I didn't ask that question. A triple A bond issued by General Motors, what would normally -- would the collateral for that bond be a specific item --

A No.

Q -- belonging to the corporation?

A No, no, it's based on their overall creditworthiness.

Q What would be the collateral for the bond?

A The assets of the corporation.

Q All of the assets?

A All of the assets subject to anything; for example, the other claims which might come ahead of it, such as bank loans which you mentioned.

Q In this case, the convertible debentures, these were subject to superior indebtedness also, were they not?

A Certainly.

Q Let's take Allegheny. What indebtedness would have come ahead of these convertible debentures back in 1974?

A I'll have to refer to the report.

Q Okay.

A Allegheny, based on its long-term debt picture in December 1973, had some $37,000,000 outstanding in debt, long-term debt, of which this issue was face amount 10,240,000, and in Note 3 of the annual report, they list these, and they list them, incidentally, the normal thing is, in terms of priority, and so that this particular debenture ranked next to bottom in terms of priority or among its debts.

Q You made a thorough study of these companies before appearing in court today, did you not?

A I made a study of these, Mr. Goldstein.

Q How did you go about preparing for your testimony today?

A We were given the -- well, we were given this problem or we were acquainted with the investments which had been made and for the client here, Mrs. Grupe, and in effect, we were asked to evaluate or examine this list of securities to determine what really we thought of them in relation to Mrs. Grupe.

Q And you mentioned, as part of your evaluation, you consulted your library in the office?

A That's correct.

Q Did you look at annual statements?

A We looked at the financial services, Moody's, and Standard & Poor's, which has statistical data on companies.

Q Did you look at the annual statements of these companies?

A We looked at the annual reports which had been provided to us.

Q Did you request information from the companies themselves?

A We did not.

Q Did you call up any officer at the company?

A We did not.

Q You testified yesterday, I believe, that most of these names you had never heard of before?

A I said that -- yes, I think that is quite right, that the majority of them are not that well-known to me -- not known to me.

Q Isn't it a fact, given the number of companies on the over-the-counter exchange, that it is probably safe to say that, most of the companies, you never heard of?

A I think that is quite right, in terms of numbers.

THE COURT: How many are there on the over-the-counter market?

THE WITNESS: Maybe in excess of -- I have a number in the back of my mind, which is something like 20,000.

Q When you advise somebody to invest in a particular company, do you first acquaint yourself with the company itself?

A I certainly try to, yes.

Q Does part of that investigation include calling up the company itself?

A That may or may not include calling up the company itself.

Q Forgetting for a moment something like AT&T or General Motors, if you had a small company, say, doing $50,000,000 a year, would you think it prudent to call up the company and get some figures yourself or get some information yourself?

A Assuming that I couldn't get them any place else.

Q Would you be satisfied with just what you found in the library and in the annual reports?

A Absolutely, because I could determine the suitability for the client on the basis of the information provided.

Q If you knew, say, the officers of the company, spent some time with them, knew the company pretty well, inside and out, would you say you would be in a better position to advise a potential investor, than if you just relied upon the documents in your library, et cetera?

A The answer to that question is yes and no, Mr. Goldstein. You used a very critical word, and the word is "inside" and "out." To the extent I had inside information, it might be --

Q I don't mean "inside" information. I was using it in the common vernacular, that you knew it thoroughly, not "inside" information.

A Would you repeat the question?

Q In other words, if you knew a company because you had taken the time to go down and seen the plant, seen the officers, talked to them, seen the financial statements, investigated what product they are doing, investigated where they stand in the field, would you consider that you would be in a better position to advise an investor, then if you just looked at cold facts in a book?

A I would be in a better position to understand the operations of the company.

Q You could get a certain flavor, also?

A You can get a certain flavor, also.

Q You get a certain feeling about the company?

A You get a certain feeling about the company.

Q Okay. Now, Allegheny, you had looked over quite well, is that correct?

A We had looked it over, yes.

Q When did the Allegheny -- when are the Allegheny debentures due?

A 1988.

Q You are sure?

A That's the date which we have here.

Q That's the date given in the Standard & Poor's?

A I have a note here in the annual report footnote under Note 3, which reads "Convertible subordinated sinking fund debentures due 1988." I guess that's the only issue which I am aware of that they have.

THE COURT: It is also the date you have in the pre-trial order.

MR. BLUM: I don't know what the discussion is about, but we will concede the maturity date is 1988.

THE COURT: He is apparently contesting that.

MR. BLUM: Then I withdraw the concession.

Q That is the maturity date listed?

A Yes.

Q You are not aware, in fact, the company has to buy them back by 1985, are you?

A That there was a pre-call feature to it, an advance call.

Q No, that the company has to buy them back by 1985; you are not aware of that?

A I do not find that in the notes.

Q How much indebtedness was outstanding on the debentures?

A On this specific issue?

Q No, when they were first issued.

MR. BLUM: Your Honor, I am going to ask that the line of interrogation be stricken unless Mr. Goldstein -- I think he is asking something not in evidence at this point.

THE COURT: Mr. Goldstein just gave some evidence and you didn't object to it. You are now objecting to Mr. Goldstein testifying?

MR. BLUM: Yes, quite a bit. I am perfectly willing to have him test Mr. Rowney's expertise, but not to test his own.

THE COURT: All right. Can we agree, however, since it is in your pre-trial order, that the description of the Allegheny securities are 6-1/4 of 1988?

MR. GOLDSTEIN: Yes, your Honor.

Q Mr. Rowney, what's a sinking fund?

A A sinking fund is a fund or a reserve which is being set aside to retire bonds prior to maturity. At least these funds are for that purpose. Let me strike that. Not necessarily for before maturity, but for providing funds so that when the bonds did become due, the wherewithal is there to pay them off.

Q Isn't it a fact that a corporation such as Allegheny -- let's stick with Allegheny -- Allegheny has bonds due in 1988? Aren't they required to repurchase some of these bonds periodically out of this sinking fund?

A They have a sinking fund arrangement which did require them to set aside a certain amount of money each year.

Q And they have to buy it periodically, buy back some bonds?

A The answer to that, Mr. Goldstein, is, they have a number of alternates: Most bonds have sinking funds which are issued today. And it requires for them to set aside funds to buy back ostensibly or to set aside to buy back at par.

If a bond is selling below par, however, which most of these were, it can satisfy its sinking fund agreements by buying these bonds in the open market at the then prevailing market price.

Now, that is a lot different than buying them at par value.

Q I am not saying "buying at par value," but they have to buy them back? They have to go into the market and buy back a certain amount to satisfy the sinking fund?

A They would satisfy the sinking fund arrangement by buying back securities, but, for example, it doesn't necessarily mean that they have to spend the same amount of money.

MR. BLUM: I take it again for clarification purposes, we are discussing bonds in general right now, and not Allegheny in particular.

MR. GOLDSTEIN: We are discussing Allegheny.

THE COURT: It is not clear.

MR. BLUM: If we are discussing Allegheny, in particular, I object to the line of questioning; and the answer is, unless it is established such a state exists here.

Q With Allegheny, was the company required to purchase not at face value necessarily, to purchase a set dollar amount of these debentures back periodically before 1988?

A That is correct, yes.

Q And they were required to do it?

A They were required under indenture. The figures I have here on table, is that the commencement date was in 1972, and that was $500,000 face amount. Face amount is the critical figure. It doesn't necessarily mean that they were spending $500,000 that year to do so, nor did it mean that the client benefited.

THE COURT: How do they determine whose bonds they repurchased when they repurchased?

THE WITNESS: In terms of, in this specific case, where we will say this sinking fund was in arrangement, they didn't know. If they had any sense at all, they would just be buying in the open market to retire bonds.

Q Therefore, a market maker in Allegheny, realizing that the company would have to buy back a certain amount of these bonds each and every year, would be in a good position to help his client, would he not?

MR. BLUM: Can we have some clarity on that question?

THE COURT: I don't understand it.

Q In other words, a market maker knows Allegheny has to buy back a million dollars of its bonds this year, has to get them from some place.

MR. BLUM: I believe the testimony was, they buy back $500,000 face value of their bonds, not a million dollars.

THE COURT: The question, as amended stands.

Q Take $500,000 they had to buy back in 1974. Would that be your testimony? In 1974, they had to buy back $500,000?

A That's correct.

Q That would be face value?

A Yes.

Q They don't want to pay face value, obviously?

A Right.

Q They would go into the market and try to buy these bonds?

A That's correct.

Q This is a thin market, is that correct?

A That's correct.

Q There aren't many bonds outstanding?

A That is correct.

Q There aren't many market makers, are there?

A Unfortunately, no.

Q So in sum and substance, the company, one way or the other, would have to go to these couple of market makers and try to get the best deal they could for these bonds, isn't that so?

A If that's the way the market is, that's where they have to go.

Q And the market maker realizing this, would be in a good position to advise his client, would he not?

A He would be in a good position to profit for himself.

Q And for his client?

A For whoever he dealt with.

Q Are you aware that out of the $20,000,000 which were represented by the convertible debentures that 10,000,000 were converted to stock or purchased?

MR. BLUM: Again, I think we have Mr. Goldstein testifying.

MR. GOLDSTEIN: I am asking the witness if he is aware.

THE COURT: I will allow it, but I think he ought to put a time frame on the question.

Q Are you aware this happened in 1973, that they were converted or purchased?

A No, sir, I was not.

Q That is not reflected in your notes?

A No.

MR. BLUM: May I ask who the "they" is?

MR. GOLDSTEIN: The company.

MR. BLUM: The company in that year?

MR. GOLDSTEIN: In 1973.

Q By 1973, $10,000,000 --

MR. BLUM: By 1973.

Q By 1973.

A That was converted into ABC common, that's correct.

Q That left $10,000 outstanding?

A That is correct.

Q Were you aware of the indenture provisions, whereby because of that conversion, Allegheny now has to repurchase all the bonds by 1985?

A No, sir, I was not.

Q You mentioned yesterday that you reviewed these debentures in the light of that -- I believe your words were "If a serious depression came, where would these holders of the debentures be?" Is that correct?

A If you say that's what I said.

Q I believe you stated -- let me see if I can quote you as close as possible -- "Analyzed companies as if depression was imminent."

A I am not sure I used those words, but I will concede the fact, we looked at these companies as to their abilities in a difficult environment as to the type of investment that we would want to have Mrs. Grupe invest in.

Q A depression was the worst kind of catastrophe you could think of monetarily?

A I would think so, yes.

Q Is it likely to happen?

MR. BLUM: I object to the question unless it is put, in terms of the question, of the time frame of the spring of 1974, at which time Mr. Rowney said he made these considerations.

Q In 1974, was a depression very likely, as we knew it, say, in 1929?

A I think that's absolutely clear.

Q It was?

A I think there was enough evidence and I think there were enough, you know, well-known economists around the world who had expressed that view.

Q You stated, one of the alternatives to buying these debentures was commercial paper, is that correct?

A I was asked if that was an alternative and that certainly is an alternative.

Q Was Penn Central issuing commercial paper in 1974?

A It certainly was. In 1974?

Q Yes.

A I do not believe so.

Q When was the last time it issued commercial paper?

A I think it was 1969 or '70. I have forgotten.

Q 1970?

A Yes.

Q And what about W. T. Grant?

A I am not sure about Grant issuing commercial paper, but it was the type of company that could very well have issued commercial paper.

Q Now, Penn Central and W. T. Grant were highly-rated companies before the catastrophe hit them, were they not?

A The answer to that is no. Neither of these companies was highly rated at the time of the catastrophies.

Q What was W. T. Grant rated by Standard & Poor's, if you know?

A Offhand, I don't know.

Q Was it rated above a B?

A It probably had a triple B rating or a Ba rating or something of that sort. I am not clear.

Q So under the definitions you read yesterday, it wasn't a speculative issue.

A It was speculative enough, Mr. Goldstein, because in the case of W. T. Grant, what the investment community has is a wealth of information which is not available in securities of this type.

Q You testified before, that you would not necessarily give an annual report to an investor, is that correct?

THE COURT: "Unsophisticated investor," he said.

Q Unsophisticated investor?

A Correct.

Q Isn't it a fact --

MR. BLUM: You are--if I may, I don't believe that was the witness' testimony. I don't believe any such question was asked.

THE COURT: I thought it was.

MR. BLUM: The question was asked: We give it to the person to read and then say, "Come back and ask me if there is anything you don't understand." I have it written out and can read it back. That's different from the question just asked.

MR. GOLDSTEIN: The witness admitted the question and the answer, so it is argumentative.

THE COURT: Move on.

Q Isn't it a fact, on a new issue, an underwriter is required to give an offering circular or a prospectus to any purchaser of that new issue?

A That's correct.

THE COURT: Were any of these new issues?

MR. GOLDSTEIN: No.

THE COURT: Then why are we talking about that?

MR. GOLDSTEIN: If your Honor will give me some leeway, the next two questions will indicate why.

THE COURT: All right.

Q You indicate an annual report is pretty well self-serving?

A It can be, yes.

Q Isn't an offering circular or prospectus even more so?

A Exactly right. Nor would I, in a position of an adviser as opposed to a broker, be giving a prospectus to an unsophisticated investor.

Q But if somebody came to you on a new issue, you would have to, under the -- if you were an underwriter, under the NASD and Securities and Exchange rules?

A That would be a requirement.

THE COURT: I still don't see why we got into that area. What does it have to do with this case?

MR. GOLDSTEIN: Your Honor, because again, aspersion, I think, has been cast on the annual reports and I want to point out, in the case of a more self-serving document, the Securities and Exchange Commission thinks enough of it to require an investor, sophisticated or not, be given copies.

THE COURT: We have enough cases in this court concerning the inaccuracies in those prospectuses, that I am not tremendously impressed, but it's not what we are dealing with here.

Q You testified, I believe, that in these debentures there was widespread volatility?

A That is correct.

Q Do you mean that the price for the bonds varied greatly from day to day?

A They would have, greatly, taking a longer spectrum say, within a six-month period or within a year period. There might be days they would not trade, so they would not move in price.

Q But it's possible they would fluctuate wildly, from day to day?

A They could. They were the type where wider fluctuations might be anticipated.

Q Does your company deal -- is your company a market maker in junk bonds?

A Our firm is a major dealer in junk bonds.

Q I see. And, therefore, some of your clients invest in these junk bonds?

A They do not.

Q You are a market maker for the junk bonds and none of your -- when I say "your," your company's clients invest in them?

A I am with the Investment Advisory Department of Drexel, Burnham, and we do not invest in junk bonds.

Q I do not mean your investment. I mean the clients of Drexel and Burnham. Clients of some broker in Drexel and Burnham; would he sell these junk bonds, that Drexel and Burnham is a market maker in, to some of his clients?

A The clients very often are other institutions or other dealers.

Q Would he sell it to an individual?

A He could sell it to an individual; that's absolutely right.

Q And such is the case a lot of times?

A I am sure that is the case, yes, sir.

Q Isn't it a fact that just about -- well, I would say every major brokerage house is a market maker in some security?

A I think that's correct.

Q And a market maker in securities sold on the over-the-counter market?

A Yes.

Q And there is nothing wrong with that?

A No.

Q How does a market maker make a profit from a sale to his customer?

A He is making the profit, essentially, on the spread. Instead of earning a commission, he is selling at a price higher, hopefully, than his cost, and that spread becomes his profit. If he sells at a price lower than the cost, that is his loss.

Q And a market maker usually has some of the securities that he is dealing in in his inventory?

A That's correct.

Q In fact, isn't it almost a necessity that he has to have the securities in his inventory?

A I believe that is so.

Q Supposing a market maker buys some XYZ Corporation for $4. Let'a make it easy. Let's do it with stock, just for the sake of argument. He buys a stock in ABC Corporation for $4. A week later a customer comes in, wants to buy ABC stock. Is there anything wrong in him selling the customer the stock out of the inventory?

A Absolutely not.

Q Supposing the market at the time he sells it to the customer, for the stock he bought at $4, is $10? Would there be anything wrong in him selling that stock to the customer for $10?

A There would not.

Q Even though he made a $6 profit?

A Correct.

THE COURT: Are we dealing here with stocks or debentures that were held in inventory?

MR. GOLDSTEIN: I said "stocks" for convenience.

THE COURT: I understand that, but were these debentures held in inventory for any long period of time?

MR. GOLDSTEIN: That will come out later, your Honor, whether they were or were not.

Q Now, just to clarify matters, the same would hold whether they were stocks or debentures?

A On the pricing, yes.

Q In 1974, were New York City bonds highly rated, in the spring of 1974?

A It seems to me the rating had been reduced in the spring of 1974. I'm not sure of the dates on this. The New York City bonds had had a rating for some years of single A rated, and then they were reduced, but I don't recall the exact dates.

Q So if it was a single A, and an investment counsel put a certain individual in New York City bonds, following the ratings, he couldn't be criticized for it later on, could he?

A That's a supposition I would not agree to.

Q Now, you mentioned that one of the issues you would have recommended for Mrs. Grupe, perhaps, in 1974, were certain utilities?

A I said "utility bonds" we gave as examples of alternative investments.

Q And they were paying 12 or 13 percent interest, I think, you said?

A Yes.

Q Why were they paying so high an interest?

A Because the interest rates at that time were climbing very rapidly in price.

Q Wasn't there another reason?

A Well, in order for them to raise the amount of money they needed, that was the going rate of interest and that's what they had to pay to sell their debt.

THE COURT: I think he is also suggesting, the oil embargo indicated that when combined with public service regulation of prices, that many public utilities would not be profitable in the future.

MR. GOLDSTEIN: With respect to the Court, that is not what I was going to suggest, your Honor.

THE COURT: All right.

Q Wasn't it a fact that shortly before the spring of 1974 Con Edison had defaulted on paying interest?

A Con Edison had cut its dividends on its common stocks, and there had been concern about the viability of that particular utility, and there was a cloud over utilities in general.

Q A cloud over utilities in general?

A Yes.

Q In fact, weren't people dumping utilities all over the country because of Con Edison?

A I don't know that that is correct.

Q Wasn't there a wide panic?

A In other utility stocks?

Q Yes.

A I think not.

Q Isn't that why the utilities were paying such high rates?

A No, I put it to you: Utility issues have always paid higher rates than similarly rated industrial corporations had, and that's been going on for some time. The rates you see here, accurately reflected the credit conditions as they existed at that time, the interest rate conditions. As we indicated, Treasury bills were at their highest yields, maybe, since the end of the Civil War.

Q But weren't a lot of people still wary of utility bonds because of Con Edison?

A The --

Q I think you can answer "Yes" or "No."

A I don't know that I can answer that. I think that is too broad a question.

MR. BLUM: I object to the form of the question.

Why don't you ask him whether he was wary of them?

THE COURT: He doesn't have to ask that question unless he wants to.

Put your next question.

Q Do you know approximately what interest was being paid on triple A bonds in May 1974?

A Triple A -- are we talking now of industrials, municipals, U.S. Government's? What are we talking about?

Q Triple A industrials.

A In the spring of 1974, triple A seasoned issues, a group index as put out by Moody's, were yielding -- and I have to do this approximate, because I am going to have a chart here -- I would say about 8-3/4 percent, in the spring of 1974.

Q So that if Mrs. Grupe was put into those investments, she could not receive $12,000 a year income based upon her investment of $100,000?

A Obviously.

Q Now, you mentioned that one of the things you would recommend to her was investments in Treasury bonds and short-term securities, is that correct?

MR. BLUM: Again, your Honor, I think he said, he would have recommended in the spring of 1974.

MR. GOLDSTEIN: That's correct. He would have.

Q Is that correct?

A Yes.

Q And these became due at the end of 90 days?

A Well, if we did the short term, that's correct.

Q And every 90 days, therefore, Mrs. Grupe would have to go out and purchase more securities?

A It depends on the conditions securing at the time the 90 days came up. She might go into that or something else.

Q But she would have to --

A She would have to make a decision or someone would make that decision.

Q And the amount of interest she was getting from these securities could go down or up?

A These are the most volatile in terms of interest rate changes.

Q You stated your fee would be one-half of one percent of the investment?

A Of the total assets under management, that's correct.

Q When would you get this fee?

A We bill a client on a quarterly basis, so that we would render a bill, say, every three months, for these services. We do the calculation on the value of the portfolio at that time.

Q Would there be a charge when she initially invested? We are just talking about an investment fee to you.

A Yes. Normally, what we would do is to charge a fee which is payable in advance.

Q What would that be?

A And what would that be?

Q Yes.

A It would be calculated at the one-half-of-one-percent rate annually.

Q In this case, Mrs. Grupe was going to invest $100,000. She comes to you in May 1974.

A Right.

Q What would you charge her at that point before you did anything, before you invested the money for her?

A If we take it at one-half of one percent, we are talking an annual fee of $500 or $125 a quarter.

Q That $500 would be the only fee you would charge over the year or is that what you would charge quarterly?

A No, no, that $500 is the annualized fee, but we render it on a quarterly basis. Other firms render a bill once a year, so that's an annual fee.

Q But you would get your fee in advance?

A The accepted practice is to get the fee in advance.

Q In addition to that, she would have to pay commissions?

A There would have been whatever -- whatever the securities transactions there would have been, transaction charges.

Q If every three months, she had to change the securities around, there would have been additional commissions at each time?

A In this case, we would not be trading -- the only thing that might be changing every three months is the U.S. Treasury bills, where the transaction charge is really quite minimal.

Q Are you aware of the certificate of deposit interest rates in 1974, the spring?

A Yes.

Q Were they going down after June of 1974?

A Well, let's take a look.

MR. BLUM: After when?

MR. GOLDSTEIN: After June of 1974.

A The answer to that question is correct and I can't be precise as far as June. What we were seeing was that interest rates, in general, peaked, you know, that summer, and certificates of deposit interest rates would have been starting to decline.

Q These convertible debentures, they fluctuate to some extent according to the common stock?

A Yes. And also, depending upon bond market conditions, too.

Q Assuming a high interest rate, a high interest period, or -- strike that.

Isn't there a bottom below which they will not go, dependent upon what the interest rate prevalent at that time is?

A What's the bottom?

Q Let me rephrase the question.

Don't these bonds also fluctuate according to the interest rates being charged, the prime interest rate, say?

A Absolutely.

Q So if there was a high interest rate, the price of the bonds may go up regardless of what the underlying stock is doing?

A If I understand you, Mr. Goldstein, I think you have got it wrong. If interest rates began to decline, the value of the bonds, theoretically, would rise. Higher interest rates would mean lower bond prices.

Q I see. So that the interest rates that you would be receiving on your return, namely, in Allegheny, $590, would be equivalent pretty much to what the prime interest rate was, or thereabouts?

A Given at this specific time, that's correct.

Q You mentioned yesterday, one of the factors which went into your analysis was that a lot of these companies showed deficits during 1973, '74?

A Yes, that's correct.

Q Isn't it true that a lot of big corporations also showed deficits?

A It was a difficult period, that's correct.

Q So it wasn't unusual?

A I wouldn't say that, in the sense there were a lot of companies which were continually profitable.

Q Weren't the car manufacturers in a difficult period of time during this period of 1974?

A That's exactly right. If the major automobile manufacturers were having huge losses, it gave us concern about a lot of smaller companies.

Q Just because General Motors was losing money, you wouldn't take that off your investment sheet, necessarily?

A We wouldn't take it off the investment sheet, but to the extent that a company has periods of deficit earnings, it reduces the quality of the earnings and reduces its stature. All things being equal, we would prefer to invest in companies who never had a deficit operation in the last ten years.

Q Does your company also deal in convertible debentures?

A I am sure we do.

Q And subordinated convertible debentures?

A Certainly. Yes.

Q The hypothetical person Mr. Blum proposed to you before, was that person more in need of growth issues or income?

A In my judgment, given the conditions which were set down, she was in need of preserving the capital which she had.

Q And was she interested more in growth than in income?

A The word "growth" was never mentioned to me.

Q In other words, if she came in to you for investment purposes, would you try to put her into issues that would pay her income; rather than issues that, say, say stock issues that didn't even pay a dividend, but over the years, would increase in price?

A That would be a fair assumption. We would be looking for a return, a current return.

Q A current return?

A Yes.

Q And that would be paramount?

A That would not take precedent over the preservation of capital.

Q Quite correct.

Now, is it usual to have widespread differences between bid and ask prices on bonds trading on the over-the-counter market?

A That depends on the particular bond or security. It will vary.

Q Assuming you put that person into a bond, would one of the things you would take into consideration be whether or not that bond was recallable at the whim of the company?

A We would look at the call features on the security, yes.

Q Isn't it a fact bond issues of AT&T or any of the joint corporations tend to be of long term?

A In recent years, we have seen them issue relatively short-term securities because the market would not tolerate 30-year bonds. They just had no appetite for it.

Q But a lot of them are 30-year bonds?

A No question about it, yes.

Q Did you investigate when the companies on the board were incorporated?

A No, I did not. In some cases, we spotted that as to how long they had been in business.

Q So you do not know if some of these companies were in business, say, for 30, 40, 50 years?

A That's a fair assumption.

Q Some of them could have been in business that long?

A They may have well have been in business that long. I am going to qualify that. Because in the nature of some of them, there were a number of mergers and acquisitions which they had grown by, so if you would try to determine the roots, it might be acceptable.

Q But one company may be under different names, could have been in existence, say, for 30, 40 years?

A Sure.

Q But you don't know whether that was true or not?

A No.

Q What business is Allegheny Beverage in?

A Allegheny is a bottler, a Pepsi-Cola bottler. It has franchises generally on the East Coast. That's the basic part of its business.

Q Do you know what franchises it has?

A I would have to refer back to the annual reports. Pepsi-Cola is essentially what it is.

Q Did they also have Sprite and Royal Crown Cola?

A Yes, they had the well-known names, that's correct.

Q As far as you could tell from the annual report with regard to the SEC action, what was the SEC seeking to accomplish by its action?

A Well, it was difficult to -- as I would understand it from the footnotes, that they were obviously concerned about the reportings which had been made, as we had indicated, regarding the debentures, and there was a serious question in my mind, anyway, on the reading as to the accounting reliability.

Q Assuming the SEC -- well, was the purpose of the SEC action, that is as far as you could tell, to force the company to change its accounting procedures?

A That, to me, was the intimation, that there was to be --

Q They weren't seeking to dissolve the corporation?

A No.

Q Put it into receivership?

A No.

Q Okay.

Now, what about a lawsuit pending in this very courthouse, U. S. against IBM? Does that lawsuit affect the investment potential of IBM?

A Mr. Goldstein, these lawsuits have been going on for so long that the street is absolutely bored with them. Considering that the legal department of IBM is greater than the Government can muster against it, we would tend to vote with IBM.

Q And you wouldn't hesitate to put a client into IBM?

A Not on the basis of the litigation as it is publicized.

Q What's the purpose of that litigation by the United States? What's the result they are seeking to accomplish?

A I wish I had our analyst on office equipment here, because I don't know that I can answer that question because I am confused by what the Government has been saying.

Q Isn't the basis -- isn't what the Government wants to accomplish, the dismemberment of IBM into smaller companies?

A It wishes to dismember a lot of things, Mr.

Goldstein.

Q But isn't that the thrust of this lawsuit?

A They are charging -- it's an antitrust action. There have been several actions against the company, and they would like to see if somehow, I suppose, it's separated out or reduced in some measure or form.

Q That is what they intend to try to do?

A Dismember it? It's your word, Mr. Goldstein.

Q Break it up into smaller companies?

A They would like to see it redirected, I suppose, in certain areas. Primarily, they are charging antitrust action under variant trust laws.

Q If the Government succeeded and IBM was broken up into smaller companies, that would have a great adverse effect on IBM stock, would it not?

A It might not. Conceivably the various pieces would be worth more than the whole, when they had looked at it. For example, we can look at another one, AT&T, where they are talking about forcing them to divest of Western Electric. That in itself would create an opportunity and conceivably the stock would double.

Q So this SEC suit against Allegheny was a minor charge and really wouldn't have too much effect on whether it was advisable to invest in Allegheny or not, would it?

A Absolutely not. In effect, what we are saying, we are raising the question on a relatively small issue kind of company, as to the quality of earnings. We are creating -- we are trying to evaluate risk; we are trying to understand, on the part of a specific client, what kind of risks can she assume? What we are saying here is that another dimension has been added which tends to make us look with somewhat suspicion as to the accuracy of the numbers which are being presented.

Q But as you testified, if the SEC won, all that would happen is that Allegheny would change its accounting procedures?

A I am not sure, because I have not read, as I indicated, the specific briefs. I am not sure what the penalties are.

Q Wouldn't it have been advisable to call up the attorneys, advise or call up the SEC and find out exactly what that lawsuit was about before analyzing the company?

A I didn't need to do that because we knew, here was a problem which normally we don't care to see.

Q Now, August 1974, some critical events happened during that month, did they not?

A As I recall, yes.

Q For one thing, President Nixon resigned?

A That's correct.

Q It was a very volatile month, was it not?

A Yes.

Q And would the same be said of July?

A I am sure that was, yes.

Q Now, granted we have hindsight, but looking back was, say, October, a little calmer?

A October was calmer, emotionally, because the resignation was past, we had a new president.

Q Did the stock market go up in late September or October?

A I think it was late October.

Q Late October the stock market went up?

A Yes.

Q Did interest rates start to come down?

A Interest rates had begun to come down.

Q So that the fact that the plaintiff may have sold her debentures in August, was just a fortuitous time, was it not? In other words, if she had sold it in October, she might have gotten -- might have gotten much more money for her debentures?

A That's really a hypothetical question. I mean, we can pick any date we wanted to and say, "You could have gotten this, that or something else, again."

Q Quite right.

Now, you were talking about thin issues. Aren't a lot of U. S. Government issues "thin" under your definition?

A Again, this becomes relative. There are Government agency bonds which are regarded as or can be regarded in the past as "thin securities." I mean the amount outstanding is, you and I could retire very nicely on, but because these are dealt with in fairly large denominations, they are thin, but the distortions are nowhere near the type of thing that you would find on a thin stock or a thin bond of this type.

Q In response to Mr. Blum's questioning, you said that if you had seen Mrs. Grupe's portfolio, you would have advised her to sell them at once?

A My advice to Mrs. Grupe, had she come to me at that time in the summer of 1974, was that there were risks here which this woman should never have assumed and should not assume now, and the best thing she could do, would be to dispose of it because we could not predict what was likely to happen.

Q Are you aware how these debentures are disposed of, sold?

A How were they?

Q How are they disposed of or sold?

A You would go to a broker and place the order for the selling of them? These are not sold the same way New York Stock Exchange companies are sold?

A No, these are over-the-counter dealers.

Q Do you know what a broker would have to do in order to sell these particular debentures?

A In order to sell them?

Q Right.

A Or do you mean by "them," from the client? I am not quite sure which.

Q No, Mrs. Grupe now comes to you and says, "I want to sell these."

A Right.

THE COURT: Why don't we have her going to Rotschil as, in fact, she did. What would Rotschild have to do to dispose of them after she indicated they wanted them sold?

THE WITNESS: Mrs. Grupe would not go into the trading department of Rotschild. She would go to some broker of Rotschild, and that broker, in effect, would give instructions to their traders to sell the security, and these specific securities they would look to see who the market makers were and they would contact them and look to sell, to arrange a sale.

Q Have you sold securities in the past?

A Have I sold securities?

Q Yes.

A Have I placed orders to sell securities?

Q Yes.

MR. BLUM: Can we have that question clarified? Are you talking about, has he performed that function in the securities industry?

MR. GOLDSTEIN: Yes. That function in the securities industry.

MR. BLUM: I didn't know if you were talking about a personal securities transaction.

MR. GOLDSTEIN: Quite right.

A No, we have placed orders for the sale of securities.

Q Are you acquainted with how over-the-counter debentures are sold, specifically?

A You are going to have to elaborate on that.

Q In other words, if you were selling a New York Stock Exchange company's stock --

A Right.

Q -- you would call up your representative on the floor, say, and say, "Sell this," and he would sell it?

A Right.

Q He would go to one place and sell it?

A Right.

Q What's done with these kinds of debentures?

A Essentially, you have to shop for the buyer, in other words, your trader, assuming you were dealing with a firm which was not a market maker himself in these securities. They have to contact and deal with that -- whoever the market makers are, to find out what market exists and what the prices, and so forth.

THE COURT: Mr. Goldstein, how much longer are you going to be?

MR. GOLDSTEIN: It will be considerable, your Honor.

THE COURT: What does "considerable" mean?

MR. GOLDSTEIN: I would estimate, probably, 30 to 40 minutes.

THE COURT: All right.

We will recess now for lunch, or at least you will recess for lunch. I must take my criminal matters during the luncheon recess today.

Take the jury out.

I again admonish the jury not to discuss the case.

Return at 2 o'clock.

(Luncheon recess.)

AFTERNOON SESSION

2:10 p.m.

(In open court; jury present.)

HARRY C. ROWNEY, resumed.

CROSS-EXAMINATION CONTINUED

BY MR. GOLDSTEIN:

Q I think, where we left off, Mr. Rowney, we were going into the way these debentures are sold.

Now, you said L. F. Rothschild, in this case, would call up one of the market makers in the debenture?

A Yes. I would say, in the normal routine, as I would understand it, is that the trading desk, or whoever was responsible for trading it at Rothschild, would contact by phone, the -- you know, the market makers of the security, to determine current prices.

Q When he got the market maker on the phone, would he say, "This is L. F. Rothschild. I have $30,000 worth of Allegheny bonds to sell," or "What would you buy them for?"

A I would hope he would be a little more circumspect than that. We would ask them for the current bid on the bond, or the spread on the bond. I suppose, try to find out, in a way, as to what the dealer was willing to take at that price. In other words, the dealer can quote a price -- let's go back to stocks bought, may be simpler -- of, say, bid $4 or $40. It may be he is only bidding for 100 shares at that price. So that your trader would try to dig out this information.

Q Isn't it true that when L. F. Rothschild calls up, they just ask the market maker "What's your price?," without telling him whether he is selling or buying?

A Yes. That's absolutely correct. Yes.

Q And then the market maker would say 5-7; 5 bid, 7 asked; something like that?

A Yes.

Q And then at that time, L. F. Rothschild, for the first time, would say whether they were selling or buying?

A That's right.

Q In the case of Allegheny, 30,000.

Let's say, the market maker said "5 and 7" and L. F. Rothschild said "Fine, I have 30,000 to sell." Is the market maker obligated to buy the 30,000 at the prices he gave?

A No.

Q Is he obligated to buy some of them at the prices he gave?

A I think he is obligated to buy some of them at that price.

Q What's the general rule regarding what's some? Isn't it five?

A Yes, in terms of bonds --

THE COURT: Five what.

MR. GOLDSTEIN: Bonds.

A $5,000 face amount.

Q Five bonds, in essence?

A Yes.

Q And he would have to buy them at $5 a bond?

A On your price, yes.

Q They still have 25,000 to go. Can he raise the price for -- well, in this case we lower the price for the rest?

A He can say, "My price is now" -- the trader would say to Rothschild, "What's your quote now?," and then he would come back with another quote or maybe the same quote. I don't know.

Q In other words, for each five bonds, he could lower and lower prices, so for the first five bonds he buys at five; the last five bonds he buys at $1?

A It could go to that extreme, yes, of course.

Q Assume there are three or four market makers. Is it customary to call up one market maker, ask his bid and ask, and then sell it?

A No. The answer is a qualified no. If the trader thought the price was in line, he would do it, but normal practice is to call up the other market makers who are usually in competition with each other.

Q To try to get the best price?

A Yes.

Q That doesn't necessarily mean in this case you would sell all 30,000 with one market maker?

A It might conceivably, if someone was willing to do it, but not necessarily so.

Q In other words, if you get a market maker who offers five for $5,000 worth, and then he offers four, you tell him you will call back, and call the market maker and get five for the next five?

A Yes.

Q And that would be good practice to do something like that?

A Yes.

Q In 1973, could you have bought bonds of triple A or double A standing, a thousand dollars face amount, for the prices listed there?

A We are talking industrial bonds?

Q Yes.

A The question: Could I have bought at those prices bonds rated single A or better?

Q Yes.

A The answer to that is: Yes, if they were older bonds and had coupons like, say, 3 percent. If they were old bonds outstanding, it could be done at that price.

Q In other words, the price itself doesn't indicate whether a bond is a junk bond, the price that they are selling for?

THE COURT: You mean the difference between the price they are selling for and the face amount, does not necessarily connote the worth of the bond?

MR. GOLDSTEIN: Yes.

THE COURT: It may also be affected by the interest rate paid on the bond as of when it was issued?

Q Yes, but the difference between the face amount and the price that you buy it, is not necessarily indicative of a junk bond?

A That's correct.

Q Likewise, is the rating of the debenture by itself indicative of a junk bond?

A I think it certainly has a lot of bearing on it, as to how the bonds are ranked or are qualified.

Q Isn't it true that there are some multibillion --

and I use the word "billion dollar" companies that have offered securities that are worth triple C or B, that are rated triple C or B?

A Yes, and they would still be regarded as junk bonds.

Q Even though they are issued by multibillion dollar corporations?

A Yes. If they had ratings of that type, I would expect a volatility to them and a quality suspicion which would warrant that -- they're being classified in the slang term as their being"junk bonds."

Q And then again these debentures would be backed up, subordinate to, perhaps, other bonds, but backed up by the entire assets of that multibillion dollar corporation in a subordinate position?

A He is last in line, yes.

Q Do you know how Standard & Poor's or Moody's goes about rating, giving ratings?

A Specifically, no.

Q Isn't it true that they pay more attention to those companies that are more widely traded than those companies that have a thin issue?

MR. BLUM: It's an interesting question and perhaps it will be reached at some point, but the witness just said he is not qualified as an expert in that.

MR. GOLDSTEIN: He doesn't know how they rate it?

THE COURT: This is a somewhat different question.

Do you know whether they pay particular attention to issues which are widely traded as opposed to those that are not?

THE WITNESS: As indicated in the ratings classifications quoted this morning, they do pay attention to that fact. Where there is minimal interest, they may not rate a bond.

Q Where there is a minimal interest, they may not rate it?

A Yes. In other words, when we read that description of "not rated," one of the reasons might be, there is a minimal interest.

Q So even if under other conditions a company may be rated triple A, it wouldn't be rated if there is only minimal interest in it?

A It's an interesting question.

THE COURT: Is it likely there would be minimal interest in a company listed triple A that was putting out a bond?

THE WITNESS: I don't think so. That's why I said it was an interesting question, because I can't think of a circumstance where that might happen, but conceivably it could.

Q Isn't it true that if a company wants to be rated, it has to pay Standard & Poor's and Moody's?

A Yes, they pay a fee. There is a fee for this.

Q And if a company doesn't pay the fee, they are not rated?

A That would be correct, too.

Q If a company, for whatever reason, did not want to be rated, they can easily avoid being rated by simply not paying the fee?

A That's right.

THE COURT: It doesn't necessarily follow. I heard of a city that didn't want to be rated, but they are having trouble getting themselves unrated.

Incidentally, do cities have to pay the fee?

THE WITNESS: Your Honor, I really don't know.

Q In the case of Nortek, Monroe -- well, Lincoln, you said it wasn't rated because of policy?

A Yes, I would think so.

Q Nortek, Monroe, Knight Industries, D.W.G. and Applied Data, isn't it possible they are not rated because they didn't want to be rated?

A It's certainly possible.

Q In the case of Moody's with Technical Op., can the same answer be given with respect to Moody's?

A I suppose so, yes. Although I would find it difficult to find that it could, would be interested in having Standard & Poor's rate it, but not Moody's.

Q It would be unusual, but possible?

A Possible.

Q You will note that there is a discrepancy between Standard & Poor's and Moody's on some of these ratings. Is that usual?

A I think it becomes a little bit semantics. They don't quite use the same letters and their definitions for each rating generally coincides, but there may be subtleties as far as differences.

Q Isn't the triple C of Standard & Poor's lower than Moody's B, according to what you read yesterday?

A I guess we will have to refer to that again.

Q Okay, if you would.

A To reread here from Standard & Poor's triple C rating:

"Bonds rated CCC and CC are outright speculations, with the lower rating denoting the more speculative.

Interest is paid, but continuation is questionable in periods of poor trade conditions."

Now, that is Standard & Poor's. Moody's definition of their B rating:

"Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small."

I think one tends to be a little politer than the other, but --

Q Well, how far down is the B rating in Moody's and how far is the triple C in Standard & Poor's?

A Okay. In Moody's bond rating, there are three ratings lower than the single B.

Q I am not asking "lower." I am asking how does it rank from the top down?

A Sixth from the top in Moody's, and the triple C is seventh.

Q In Standard & Poor's?

A Yes. CCC is seventh in line from the top.

Q Recently, I think it's public knowledge, Moody's ran into trouble with the City of New York about its rating, did it not?

A I think New York City ran into trouble with Moody's.

Q Touche. Neverthelss, there was a criticism of Moody's over the rating?

A There has been much publicity and criticism of Moody's rating of certain municipal securities, and the city did protect loudly when there was a drop in the rating, which proves the significance and importance of the rating on the investing public, because they are listened to.

Q But Standard & Poor's did not follow Moody's lead, did it?

A No, it has not.

Q And there is a big discrepancy between the two?

A They seem to be having a professional difference.

Q At one time, New York City was rated -- well, not at one time but within the past three years, say, going back to 1973, New York City was rated rather high by both services, were they not?

MR. BLUM: Again, I think the question could be asked with greater clarity for the expert. Actually, when we were talking about New York City before, there were Big Mac securities, which were different, and then there are New York City bonds and notes. It would be helpful if you are going to discuss changes in these ratings in these multibillion dollar issues, to identify them.

THE COURT: I think you better, but it's pretty far afield in any event.

MR. BLUM: I believe so.

MR. GOLDSTEIN: At this point, the ratings themselves are at issue. They were brought into issue through this expert.

THE COURT: If you are attempting to establish that the ratings often prove to be inaccurate and that bonds with fairly high ratings sometimes take a tail spin shortly thereafter, proving that the system is not infallible, I think the witness will have to concede that.

THE WITNESS: Absolutely.

MR. GOLDSTEIN: Okay. That's all I would need on that.

THE COURT: Even Jimmy the Greek misses a few.

Q In these debentures, did any of those debentures have a bond preceding them?

A Just the one that we are talking about, the Allegheny's before; I think there was another debenture issue ahead of that, I believe. So that the answer to your question in general is yes.

Q And some of them do not?

A Some of them do not, yes, sir.

Q In the case where they did not have a bond preceding them, would the convertible debentures, in essence, be similar to a bond?

MR. BLUM: If you are going to ask a question like that, it has to be asked with some specificity.

MR. GOLDSTEIN: He can answer in general terms.

THE COURT: Let him try to answer it.

A Would you repeat it again, please?

Q Where there was no bond, or other convertible debenture before the convertible debenture we are talking about, in any of those issues, would that convertible debenture then be the same as a bond, as far as --

A Well, the answer to your question is yes, if there is nothing senior to it -- I mean then that's the only long-term debt for getting back, the answer is yes.

Q In other words, some of these were not subordinated debentures?

A The answer to that is: With a subordinated convertible debenture, the company could issue bonds at any time thereafter which would precede it in this classification or category, so whereas at the time they were outstanding there may have been no other long-term debt ahead of it, that didn't preclude other debts being issued which would rank ahead of it in the event of liquidation.

Q I believe you testified that the reason a company would issue a convertible debenture rather than a bond was to keep down the interest rate?

A Yes. The companies would have several reasons for issuing convertibles. Because of the speculative play of a convertible bond, the speculation on the growth of the underlying common stock, they are able to generally sell them at lower rates of interest than a straight or a non-convertible bond.

Q I believe, in answer to Mr. Blum's question, you stated that one of the corporations selling commercial paper at the higher end of the spectrum, the 11-point-something percent in 1974 was G.M.A.C.?

A I have indicated, in terms of names, I thought there were names such as General Motors, Sears, and people like this who were steady commercial-paper issuers. Whether they did, then, specifically, or not, I don't know.

Q You don't know if they were getting the highest percent?

A They wouldn't be paying -- because of their own credit rating, they would be paying the lowest yield for that type of security. Other issuers of less credit worthiness would be paying more or paying higher.

Q That's what I want to clear up. I believe, at the time, we were talking at the upper end of the spectrum, and you said the commercial paper went up to 11-point-something percent of prime companies in the spring of 1974.

Is it your testimony now, that General Motors Acceptance Corporation would be much lower down on that spectrum?

A I think we have a semantics problem again. General Motors would be a prime commercial paper issuer. This chart, as prepared by the Federal Reserve for the year 19 -- it would appear that the rates on prime commercial paper of four to six months were somewhere in the vicinity of 11 percent.

Q Issued by General Motors?

A You are trying to pin me down to General Motors and I have no specific knowledge of General Motors. I am saying General Motors is a prime name.

THE COURT: Why are we pursuing this? What is it all meant to prove?

MR. GOLDSTEIN: Because in discussion, during

Mr. Blum's examination he mentioned, "Give us some names of corporations who were issuing commercial paper," and I asked him to limit it to the upper end of the spectrum, which he proceeded to do; and I think Mr. Rowney then indicated General Motors and Sears were paying 11 percent on their commercial paper at that time. I just want to make sure --

THE COURT: I don't think that is exactly what he did, but even assuming that he did, so what?

MR. GOLDSTEIN: If that's the case, I would inquire as to who was on the lower end, if General Motors was at the upper end. I think it casts credibility on his previous statement, and it's part of cross-examination.

THE COURT: He started off by saying he didn't know who was offering short-term paper at that time, but he took a couple of companies whom he knows are continually offering short-term paper and he mentioned them.

MR. GOLDSTEIN: As long as the record is clear that he didn't necessarily mean that they were paying 11 percent at that time. If that's his testimony, fine.

THE COURT: I think he testified that most short-term paper at that time was going for about that rate.

THE WITNESS: Yes.

THE COURT: So it's really a question of knowing who was offering it, which he said he didn't know, but based upon experience over the years, he assumed that the two companies he named were probably in the field at that time.

Let us move on to something a little more germane.

Q How much volume in sales did Technical Op. do during 1974, according to the documents before you?

A I have notes on this, if you don't mind.

Q Sure.

A For the year ended 1973, they had a volume of 79,000,000.

Q 79,000,000?

A 79,300,000.

Q What about Nortek?

A Nortek had gross revenues of 41,000,000.

Q And Elco?

A Elco had gross revenues of $27,000,000.

Q 27?

A $27,000,000.

Q And D.W.G.?

A D.W.G. had $97,000,000.

Q As far as Knight Industries, what's their main business?

A They were in the gas compressor -- they manufactured gas compressors.

Q Do you of your own knowledge, or have you learned through your analysis of these companies, where Knight rates among other companies in that particular field?

A No, I don't.

Q Would you think that that would have been important in advising a client to purchase Knight Industries?

A The problem that was put before me was not a question of whether we would purchase Knight Industries.

Q That's correct. But if somebody wanted to purchase Knight Industries, wouldn't you, as a normal course of action, see where they stand in their particular field?

A Considering the size of the company, their volume is relatively small, that would certainly be the case.

Q And if you discovered, for instance, that Knight had a virtual monopoly over gas compressors, which every oil company needed, that would tend to lend some importance to your recommending a purchase in that area, wouldn't it?

A Even companies with monopolies can run into financial difficulties, and as they indicated in their annual report, they were concerned about the outlook for 1974. As we saw, also, from their annual report, there had been accumulated deficits in the past years. Obviously, they had had losses earlier on in previous years.

Q Regarding Elco, isn't it a fact that Elco, subsequent to 1974,the common stock of Elco was purchased by Gulf & Western Industries for $15,000,000?

A Gulf & Western acquired Elco Corporation, that is correct.

Q For $15,000,000?

A Yes, I guess that's the price.

Q What would be the purpose in advising somebody to invest in several issues rather than in one? What would be the main consideration, put it that way?

A To spread the risk.

Q In other words, given any set of stocks, bonds, debentures, whatever, there is always the chance that one or two might fail?

A Absolutely.

Q And if you knew for a certainty that they wouldn't, then, conceivably, you could invest in one issue?

A That's correct.

Q And in almost any portfolio, usually one or two do not work out as well as the rest?

A Usually one or two don't work out as well as the rest in terms of earnings anticipation or price performance.

Q As far as making a profit also when the time comes to sell?

A Yes, sir.

Q In this case, do you have present knowledge as to how these companies are currently doing?

A We have recently just got some very quick figures together as to seeing where they stood.

Q Where did you get these figures from?

A Well, essentially, I went again to my library just to see what happened to them, to see what they were earning, and things of that sort. We do not have up-to-date annual reports on them.

Q How far up to the present time are you able to give us a statement as to the present liability of these companies?

A As to the present liability or viability.

Q I don't expect you to say today, these companies are doing so and so, but how close to the present time did your research take you?

A In terms of examining to see what's happened to it, subsequently, Elco was acquired by Gulf & Western

Industries, Arwood was merged into --

Q Well, if you could just answer the question first.

THE COURT: His question to you: Was your research about their present condition, was based upon how current sources?

THE WITNESS: Well, I referred to --

MR. BLUM: Again, I think you should do this just for record purposes, although I don't know what the answers will be. We have had discussion on it and I simply feel obliged to observe that I do object to the line of questioning which relates to subject matter concerning where these securities are now, those which have gone into brankruptcy as well as those which may be up, because I don't think it bears on the case.

THE COURT: I have already advised the jury: knowing the score after the game is over, doesn't indicate how smart you were before, though it does tell you whether you are winning or losing; but particularly as time passes, and I guess now that two years have passed, the current status of the companies is not particularly or even slightly evidentiary as to the value of them, as investments, two years ago. However, shortly after and for a continuing period of time, it has some relevance. He is now only going to tell us as of when he looked at them.

MR. BLUM: With that qualification, I withdraw my objection.

A As I said this morning, Mr. Goldstein, when we were confronted with the problem originally, it was the hypothetical one relating to the year 1974, and we had avoided looking to see what happened to these currently. As of this past week, and only this past week, we have made a cursory examination as to what's happened to these corporations since that time, and that cursory examination has to do with current earnings or most recent earnings and prices on these securities, and that's the depth of that work.

Q Now, Elco, you have already testified, what happened to it: it was purchased by Gulf & Western.

A Yes.

Q The next one you were going to mention was Arwood?

A Yes. Arwood was merged into a company called "Interlake Corporation," so it no longer exists per se, as Arwood; although with debentures, you know you will go out and find something called "Arwood Corporation debentures," because these still exist in the trade as such.

Q Is Interlake a large corporation?

A It's a large corporation, as is Gulf & Western Industries.

Q They are similar in size?

A I think Gulf & Western is larger in terms of gross volumes.

Q But Interlake is, say, over a billion dollars?

A Yes.

Q What happened to technical operations?

A I don't think there's been any -- oh, Technical Operations is still -- it's still operating the way it has been. I am looking, if I had another -- yes, the only thing I have is an earnings figure, is the most recent annual earnings figure on Technical Operations, is that they had a deficit this past year of 24 cents. They operated in a deficit position.

Q Have they, since they issued the debentures, continued to pay interest when due on those?

A Yes.

Q There has been no default?

A There has been no default.

Q What about Nortek?

A The same with Nortek. It's operating. It earned 64 cents a share last year. They are still viable and working.

Q And, again, haven't missed any payment?

A Correct.

Q What about Monroe --

THE COURT: Rather than do it one at a time, couldn't we take cumulative figures?

MR. GOLDSTEIN: The problem is, some have gone up; some have gone down.

MR. BLUM: And some have gone bankrupt.

A You haven't asked me prices. If you want prices, I can do that.

Q We will get to that. I just want the general area right now.

Well, would you say -- let me ask you the general question. All of those companies that are still in being, or have been merged, have never been in default of any of their interest, have they?

A The answer to that is no. Lincoln National Mortgage or Lincoln Investment Mortgage has not defaulted on its convertible debentures, but had defaulted on other debt with its banks, so that there has been a debt restructuring taking place with its creditors.

Q Right. That's similar to what happened with, say, Chrysler Corporation?

A You tell me.

Q. Well, isn't it, where they defaulted on loans to the banks and there was a reorganization?

A I don't think, exactly. I don't know that Chrysler actually -- they got together before there was a default. Chrysler Corporation was not in default.

THE COURT: The question was qualified in terms of those who are still in business.

Are any of them out of business or have any of them ceased paying interest?

THE WITNESS: The Monroe group filed for bankruptcy in January of 1975.

Q Filed for bankruptcy or reorganization?

A I am sorry, it filed for reorganization under Chapter 11 of the Federal Bankruptcy Act.

Q Did it come out of reorganization?

A I don't think so. I don't believe so. At least, in terms of bringing myself up to date, the first thing we looked at was: where are the securities. I could find nothing in the manuals other than a note which said, "Filed for bankruptcy," or "Filed for reorganization."

Q So you don't know if it came out or not?

A I don't know the status today.

THE COURT: It's not presently paying interest on its bonds.

THE WITNESS: I can't find the securities as being traded any place.

THE COURT: Did any of the others cease paying?

THE WITNESS: No, none of the others have ceased paying interest, your Honor.

Q What's an acceptable capital-to-debt ratio?

A It, obviously, varies between industries. In the case of utilities which are regulated and near monopolies, where they get certain rate assurances, they have frequently, and it's customery with having a fair amount of debt in their balance sheets, so that debt-to-total management can be fairly high: 50 to 60 percent.

Q What about in the case of General Motors?

A In the case of General Motors, their long-term debt is relatively low in relation to their total capital.

Q I am talking about their entire debt to their capital; is it about 2:1, 1:1?

A If you are talking in terms of their bank loans, and things of that sort, I don't have access to that. I don't have those figures here.

Q I don't want the exact. Isn't it usually about 2:1 or something like that?

A I really wouldn't know the answer to the question. I know their total long-term debt in relation to total capitalization is probably minor, probably less than ten percent.

Q What about current assets to current liabilities?

A In the case of General Motors?

Q Yes.

A I am sure that ratio -- I would feel that ratio rate now is extremely high: 3:1 or better. Again, I don't have that information.

Q Looking at Elco, what's their ratio between current assets and current liabilities?

MR. BLUM: Can we have a time frame for the question?

THE WITNESS: That's the only way I can answer the question.

Q 1974?

A We had a ratio of 4:1.

Q Would you consider that good for Elco?

A That was a good cash position they were in, a good working-capital position.

Q Mr. Rowney, are you getting paid for appearing today?

A I have been asked to appear as an expert witness and I'll be compensated for my time and expertise.

Q By the plaintiff?

A I guess, through Mr. Blum's office. I am not sure where I will get it from. I'm going to send someone a bill.

Q Back in 1974, what was the Nortek ratio?

A 3.3.

Q To 1?

A Yes, sir. Correct.

Q And that, again, would you consider satisfactory for that company?

A To the knowledge we had, yes.

Q Let's see if we can sum up and let you go home.

As far as the rating, isn't it true that they have various fallacies?

A I can't --

MR. BLUM: May I object to the form of the question. I don't understand what it means.

THE COURT: Sustained.

Q These rating services are not infallible?

MR. BLUM: Again, I will object to the form.

THE COURT: That I will allow.

MR. BLUM: I will concede they are not infallible.

THE WITNESS: So will I.

Q Will you also concede that, especially with small companies, an intimate knowledge of the company is important in whether or not to advise somebody to get into them?

A I think that's absolutely correct.

MR. GOLDSTEIN: No further questions.

THE COURT: Redirect.

MR. BLUM: I will try to be quite brief, your Honor.

THE COURT: Good.

MR. BLUM: I don't always succeed in what I try to do, unfortunately.

REDIRECT EXAMINATION

BY MR. BLUM:

Q Let's take some of these points, so there is no misunderstanding possible on the part of the jury.

You said you discovered that Elco Corporation was acquired by Gulf & Western Industries sometime during the summer of 1974; is that correct?

A I'm not sure if it was '74 or not.

Q I have a document which may refresh your recollection, which was attached to a request to admit and which was acknowledged to be a document received by Mr. Lamula. Does that document and the date on it refresh your recollection as to when that acquisition of Elco took place?

A Yes, I can't make out what this document is. I'm not sure where it's from, but the date on the bottom is July 3, 1974.

Q Can you read what it says on top?

A It says "Notice to Holders of Elco Corporation 4-1/2 Percent Convertible Subordinated Debentures due February 15, 1987."

Q There is a passage which I pointed an arrow at in ink a few minutes ago.

Would you read what happened to the debentures in terms of whether or not they were backed by the mammoth assets of Gulf & Western?

A Yes. As indicated in this notice, to quote:

"Notwithstanding the merger, holders of debentures will continue to be entitled to look only to Elco for payment of the interest and principal with respect to the debentures."

Q Again, rating services are not infallible, you have testified. They are important in determining suitability, is that correct?

A They are important in determining suitability.

Q In the description which you gave respecting the manner in which a house like L. F. Rotschild and Company, or presumably your own, which is a house of like reputation, goes about selling junk bonds, when you referred to the discussions which took place, who has those discussions, the registered representative, or are they discussions with the market makers, or the broker dealers who deal in this?

A No, it would be the firm, the L. F. Rothschild's, in this case, own trader. They have men who that's their job, is to professionally trade with other professional traders on market makers.

Q In short, functions are divided in the larger firms, is that correct?

A Absolutely.

Q A different person does the actual trading or negotiating from the persons who do the counselling of the client?

A Correct.

Q This morning, when we cross-examined -- when you were cross-examined by Mr. Goldstein, you stated from your general knowledge how a market maker obtains or makes profit. Then you talked about having stocks or bonds, over-the-counter stocks or over-the counter bonds, in inventory.

Are you familiar or aware, from your general expertise, of the types of situations in which the market maker in question does not normally carry an inventory, but rather, goes about buying the debenture, if it were such, at a time when it appears that he has a buyer at a price that makes sense? Are you familiar with that type of situation?

A Yes. It's not unusual for an over-the-counter dealer or market dealers to be out of inventory, let's say, or they don't have to consistently maintain an inventory on a security, particularly a thin or inactively traded issue, so if they have an order to buy a security, they will look around to try to find the amounts which are being sought after, and if they find it, then resell it to the retail buyer.

Q Is there a term that is used in Wall Street or in the securities industry to describe that situation in the records of a market maker?

A Yes, it's a workout field. He says, "Yes, we are a market maker, but this is going to have to be worked on, worked out to provide what you want."

Q And, if you know, is the practice on measuring profit the same when you are dealing with a workout situation as it is in situations where you are dealing with a constant inventory?

A Generally, I believe it is less --

MR. GOLDSTEIN: Objection. The witness says "he generally believes." I think the rest of his answer should not be allowed.

THE COURT: If he is talking about a general practice, that is allowable.

MR. BLUM: I am not asking him any of these securities, and I believe the witness never qualified himself as more than generally familiar with the subject that he was examined on by Mr. Goldstein.

MR. GOLDSTEIN: Your Honor, he has just said, "I, generally, believe." That indicates he is not an expert. That's going upon his opinion, which is not an expert opinion, and therefore, I respectfully submit: any testimony in this area is incompetent.

THE COURT: I can't tell. I don't know what he meant when he said "he generally believed."

Are you indicating that you are not certain or that there is a general practice? Which?

THE WITNESS: There is a general practice, but I am not specifically certain that this occurs at all times.

THE COURT: Tell us what you understand to be the general practice.

A Well, the general practice, say, on a workout deal is that the dealer's mark up could or would be less because he is at risk less, because he's got a potential buyer; he is not holding securities. If he can find someone who is a seller, he can really put them together with no risk or little risk to his capital, so that the markup on that should ostensibly be less.

Q Based again on your general experience, in the spring of 1974, with over-the-counter broker dealers as opposed to those which also maintain large operations on the major security exchanges, dealing with the lesser broker dealers, what was the economic impact on such organizations of the economic turbulence that you described yesterday?

A It was devastating. That was a red-ink year for the investment community in general. And the smaller houses and the over-the-counter dealers were having difficulties. Volume had dried up. In other words, the activity of trading was subdued because people didn't know what was going on. Prices were declining, so that if you were holding issues at inventory, you ran the risk of seeing the value of that inventory decline as market prices declined.

So it was a difficult year to be in that particular business.

Q The phrase was used either by you or by Mr. Goldstein, my note doesn't indicate which, that when you were describing the general practice of making market here, one would call perhaps the two or three market makers in the security.

Well now, if there are only two or three market makers in a low-rated issue of a small business, does that, in your judgment, have any effect on the suitability of such a security for our hypothetical client?

A Yes, because in effect it shows that we could anticipate above-average volatility in the price of the securities. And volatility -- the greater the volatility, the greater the risk.

THE COURT: Is that it, Mr. Blum?

MR. BLUM: Almost. I am just checking my notes to be sure I've got it all, your Honor.

Q There may have been some unclarity on the manner in which your firm charges its fee for the services rendered?

THE COURT: Even if it is, it's a matter of no consequence and we are not going over it a third time.

MR. BLUM: I just wanted to find out if it's a fairly standard practice.

THE COURT: He indicated it was.

THE WITNESS: It is.

Q There is one other point.

Mr. Rowney, if one buys a certificate of deposit in January of 1974, or, indeed, January of 1976 -- that is, one deposits money with a bank and receives a certificate that indicates the right to recover that in six months, and that certificate specifies a rate of interest, let us assume 8 percent, is there any way in which the holder of that certificate of deposit can know what the interest rate of the certificate of deposit will be when it next falls due -- that is, in January or February or March? Can that person tell what the interest rate is going to be in six months later or three months later?

A Absolutely not.

Q Why is that?

A Because that interest rate on the certificate of deposit is going to reflect overall interest rates in the market, and no one can really predict that. That's a hazardous game.

Q That fluctuates from day to day?

A Yes.

Q In July of 1974, were interest rates of certificates of deposit, if you know, on certificates of deposit, higher or lower than they were six months earlier? Did they go up or down?

A They would have been higher.

Q One last question.

Is this, in your judgment, what's regarded by investment counsellors a diversified portfolio for the entire assets of a hypothetical client such as I have described?

A Absolutely not.

MR. BLUM: I have no further questions.

MR. GOLDSTEIN: Just a couple on recross, your Honor.

RECROSS-EXAMINATION

BY MR. GOLDSTEIN:

Q Under NASD rules, isn't a riskless transaction that transaction which takes place within the same day?

A I am not specifically familiar with the NASD rules as they would apply to a dealer, but -- I'm going to have to beg off on that.

Q Let me ask you this: What's the accepted definition of "a riskless transaction"?

A One where you have a back to back -- what I call a "back-to-back trade."

Q In the same day, isn't that so?

THE COURT: He has already said he doesn't know about that.

MR. GOLDSTEIN: He said,"under NASD rules," your Honor.

Q Isn't it accepted only in the same day?

A It could be. I can think where you could do it in the afternoon for execution the next day. In other words, it could be an overnight thing. That's why I am fumbling with my response.

Q As far as these certificates of deposit, I believe you testified that certificates of deposit went down after June 1974?

MR. BLUM: I don't think he did.

THE COURT: I think he said "after July of 1974."

MR. GOLDSTEIN: Or after July?

A That summer was generally the peak of short-term interest rates. They began to decline after that.

Q Isn't it true, a banker could tell a customer, "When your certificate of deposit is going to be renewed in June, it can be renewed if you want at a lower rate"?

A You can say, come May -- if interest-rate structures had begun to change, they could say with some assurance, "The likelihood is that we will not renew this at the same rate because what we are issuing them for now is this and this."

MR. BLUM: I have one more question.

THE COURT: I can't imagine why. This certificate-of-deposit question is so collateral, why is it worth going into again? She wanted out of certificates of deposit; she got out. Nobody is contesting the movement of certificates of deposit.

MR. BLUM: I think there has been some testimony and likely to be a good deal more, your Honor, about what was said about what might happen to the interest rates on that certificate of deposit. If I may, I think one, and no more than two questions, would resolve my problem with it.

THE COURT: All right.

REDIRECT EXAMINATION

BY MR. BLUM:

Q Between January and July 1974, did interest rates on certificates of deposit pretty much generally climb?

A Within that period, yes.

MR. BLUM: No further questions.

THE COURT: You are excused.

(Witness excused.)

THE COURT: Next witness.

MR. BLUM: I asked Minnie Vena, the secretary-treasurer of Lamula Investors to be here.

MR. GOLDSTEIN: She's on her way. If we take a short recess, she should be here.

THE COURT: If you don't find her in five minutes, call another witness.

MR. BLUM: If not, I will. I have only one witness beyond that.

THE COURT: All right.

(Recess.)

(In open court; jury present.)

THE COURT: Call your next witness.

MR. BLUM: Miss Minnie Vena.

MINNIE VENA, called as a witness by the plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BLUM:

Q Miss Vena, where do you live?

A 264 East Broadway, New York City.

Q Where are you employed?

A What is it?

Q Where are you employed?

A With John Lamula Investors.

Q What's your capacity with John Lamula Investors?

A I can't --

Q What job?

A I am secretary.

Q Do you hold any office in the corporation?

A No.

Q Do you sign yourself "secretary" and "treasurer" on corporate records?

A I do.

Q How many employees are there in the regular -- regular employees are there in the office of John Lamula Investors?

A Presently, there are -- one, two, three -- three with us; and John Lamula, is four.

Q And in the spring of 1974, how many were there?

A I believe there were six or seven. I can't say for sure.

Q With regard to the procedures which were followed in your office with respect to a new account, what records were opened by John Lamula Investors when a new client --

A With new clients?

Q -- when a new client came in in the spring of 1974?

MR. GOLDSTEIN: I would object. I think we should get information as to Mrs. Grupe's account, what they did with that account.

THE COURT: Ask about Mrs. Grupe and then ask if that was the way it was normally done.

Q Do you recall the opening of the account of Bernice C. Grupe, the plaintiff in this action?

A I do.

Q What was done, if you remember, with respect to opening account records for Mrs. Grupe? What was done by John Lamula Investors, if you know, with respect to opening records with respect to Bernice C. Grupe?

A Are you talking about my personal duties?

Q What was done by the office, if you know?

A Well, they sent her an office record card for her signature, which we must have for signature comparison; confirmations were sent out when they purchased stocks or bonds; annual reports are sent out when they purchase items; interim reports --

Q Just for opening the account -- let's do it this way.

I show you Plaintiff's Exhibit 1 already in evidence, which is a copy of a document, and ask you if you can identify that.

A I could, but I would like to have my glasses. I left them in the back.

(Pause.)

Q What's that?

A This is part of an office record card.

Q And an office record card with regard to whom?

A To Beatrice Grupe -- Bernice Grupe.

Q Is that your writing at the top?

A Yes.

Q What does it say in your writing?

A I returned card -- let's see now. Oh, I returned this card because it was incomplete.

Q I see.

A It was incomplete.

Q What does your writing say?

A "I returned card to be completed." This was scribbled. She called and said, "Leave it as is, will do." And that was my notation.

Q And the initial "M" there is your initial?

A Yes.

Q Is there any other information which is sought by John Lamula Investors on the opening of a new account besides this?

A Well, the customer has a customer sheet which we keep in file all the time.

Q That's your own internal record, is that correct?

A Right.

Q Is there any other information form that is required of the customer, that is for the customer to fill out and send in?

A Actually, no. They complete the office record card and give us all the information on the card, back and front, if they'd like to.

MR. BLUM: I would like to hand this to the jury, your Honor, so it can be reviewed while we go ahead, of course.

THE COURT: What exhibit number is it?

MR. BLUM: Plaintiff's 1.

Q Do you have the original order tickets which were part of the original records which I subpoenaed?

(Documents handed to counsel.)

Q I show you two pieces of paper which are fastened together, and ask you if you can identify those pieces of paper.

A Yes.

Q What are they?

A They are purchase or sales slips.

Q What's that particular one?

A This particular one is, we sold Allegheny Beverage, 30,000.

Q Whom did you sell it to?

A Bernice Grupe.

Q When did you sell it?

A May 23, 1974.

Q And what was the price?

A I got three prices.

Q No, no. What was the price for which you sold it to her?

A On the confirmation, 59.

Q Is the blue slip the order ticket?

A Yes.

Q Is that filled out in your handwriting?

A Most of the time, yes.

Q This one, the one in front of you?

A Yes, this one is my handwriting.

Q In connection with this transaction, do you know how the price of 59 was established?

A Well, I got the quotes during the day and it's established from the quotes of the day.

Q You got the quotes of the day?

A Right.

Q How did you go about doing that?

A I got the name of the brokerage house from the bond sheets and called them.

Q Were those bond sheets the yellow sheets?

A Yellow sheets.

Q Issued by the National Daily Quotation Service?

A Right.

Q And you called the houses listed?

A Right.

Q Is that correct?

A Right.

Q Now, by the way, 59 means, again, $590 per thousand of face value, doesn't it?

A Right.

Q On the back of that ticket, there is a date, isn't there, stamped onto it, and a time?

A Yes.

Q What are the date and time stamped onto the back of that one?

A May 23, at 12:05 p.m.

Q There is another stamp on there, too. It says "1211," isn't there?

A 1211 was the last quote I got, and that's when I wrote the ticket out.

Q Now, what does -- on the back, that is your handwriting on the back, isn't it?

A Yes.

Q It says "55 high," then "59" and then underneath that appears "M-u-r-p."

What does that stand for?

A 55 - 59 Murphy. Murphy & Durieu and Company.

Q What's Murphy & Durieu and Company?

A A brokerage house.

Q Are they a market maker in Allegheny Beverage convertible debentures?

A Right; at that time they were.

Q Did you look at the price, that Murphy & Durieu had quoted in the yellow sheets, that had most recently come in to you when you established that price?

A I don't know what you mean.

MR. GOLDSTEIN: I object to the question "when she established the price." She just testified this was the price given to her.

Q Excuse me, did you fix the price of 59 for the sale of the Allegheny?

A On that date?

Q Yes.

A No.

Q How was the price of 59 established, at which these debentures were sold by your firm to Mrs. Grupe?

A I give these prices to Mr. Lamula when he is in and he establishes the prices.

Q So the price of 59 was established by him?

A Yes.

Q I see.

Can you also examine the yellow sheets?

A On that date?

Q On that date or the day before, to assist in the process of determining the price?

A I have to use the bond sheets every single day.

Q All right. Now, did you look at the quotation in the bond sheets for Murphy & Durieu?

A I can't remember that far back.

MR. GOLDSTEIN: At this time, I object. Her testimony is: she called up and got the quote from the various houses; she did not set the price. Therefore, any question about what has to do with eventual price-fixing should rightfully be asked of Mr. Lamula, not of Miss Vena.

THE COURT: Overruled.

Q Did you, when you looked to see who the market makers were and gave a call, look at the prices, also?

A I look at the prices, sometimes.

Q Well, that's a fairly usual practice?

A Because the prices are from the day before.

Q Yes. So that if May 23rd was the date, May 22nd would have been the sheet that was actually latest in the office, isn't that correct?

A It would be dated the 22nd, and I would get it on the 23rd. The prices would be of the 22nd.

Q Yes.

Now, here's a yellow sheet already marked as Plaintiff's 118. Am I correct in my notation there, that Murphy & Durieu were quoting a price on May 22nd of 43-48?

A Yes.

Q Looking again at that blue ticket, the next item down says 53-57, and then it says "W-e-c-h." Is that your writing, too?

A 53-57?

Q Yes. Is that your writing?

A Yes.

Q Does that represent a quotation?

A Yes.

Q From whom?

A 53-7 was Wechler.

Q Wechler & Krumholz?

A Yes.

Q Would you look at the yellow sheet for May 22nd and tell us what Wechler & Krumholz was quoting in the yellow sheet at that time?

A 44-9.

Q 44-9?

A Or is it 8?

Q I think it's an 8. Take a close look.

A It could be an 8.

Q All right.

Now, is there anything else listed below there? It says on your blue sheet, the order ticket, 55-60, doesn't it?

A I have Carl Marks, 55-60.

Q That's another market maker, isn't it?

A Right.

Q And would you look at the yellow sheets and see what Carl Marks quoted the day before and what was in the sheet that was in your hand on that day as Carl Marx's quotation?

A Yes.

Q What was it?

A 42-7.

Q 42-47?

A Right.

Q Is this an accurate copy of the blue ticket you have just looked at?

MR. BLUM: I think we can stipulate it is, can't we, so I can hand that to the jury?

MR. GOLDSTEIN: Yes.

MR. BLUM: At this time, your Honor, before asking my next question of Miss Vena, I would like to read to the jury from Plaintiff's 127, which is the yellow sheet for May 23, 1974, the date it is containing information provided that morning by the market makers, but actually not distributed and published until the following day.

MR. GOLDSTEIN: Your Honor, with the proviso, I think the jury should be instructed that these are usually made up 10 o'clock in the morning.

THE COURT: All right, I will so instruct them.

MR. GOLDSTEIN: So this is two hours before Miss Vena had called.

MR. BLUM: On the following day, from the yellow sheet which Miss Vena had read, she had read the May 22nd listing, on the morning of May 23rd, John Lamula Investors on the same day that it sold at 59, was quoting 42-48. The firm of Suplee -- there is no listing on the Suplee firm. That's the only quotation which appears in the sheets on May 23rd.

No, there is another one. No, that's a different issue, isn't it?

42-48.

I also would like to read the quotation -- no, I beg your pardon, the previous sheet also involves the same day, May 23rd; there are other quotations.

Wechsler & Krumholz, on the day on which you had indicated 53-57, was quoting in the yellow sheets two hours earlier 44-49. And Carl Marx and Company was quoting 42-47, when two hours later you indicated that they were quoting 55-60.

And Murphy & Durieu, at the time you indicated that--two hours before the time you indicated that they were quoting 55-59, was quoting 42-47.

Carr Securities Corporation, one whom you did not call, was quoting 45 and 50 on the date on which these were sold to Mrs. Grupe at 59.

THE COURT: Do you have the following day?

MR. BLUM: Yes, your Honor.

On May 24th, Murphy & Durieu is listed at a quotation of 42-47, and Wechsler & Krumholz is listed at a quotation of 44-49. Carr Securities Corporation is at 53-57. Carl Marx and Company is quoted at 42-47.

Those readings were from Plaintiff's 136.

In case a little more continuity is needed, I would like to read from Plaintiff's 109, which is May 21st, and I do that for a reason: because as the Court will note, the order tickets which constitute Exhibits 2 through 10 show a trade date of 5-22-74, not a trade date of 5-23-74.

MR. GOLDSTEIN: Your Honor, it's been conceded by counsel and stipulated that the trade date was May 23rd. That's been conceded in the pre-trial order and it's been conceded in the admissions.

MR. BLUM: It has not been. The admissions specifically cite "on or about."

THE COURT: The confirmation I have in front of me was originally dated the 22nd and somebody inked over it the 23.

MR. BLUM: That's correct, so it may be relevant to see what it says on the 21st.

THE COURT: All right, give us the 21st.

MR. BLUM: Allegheny Beverage quoted by Murphy & Durieu, 44-49; by Carr Securities Corporation at 45-49; by Carl Mars and Company at 45-50; and by John Lamula Investors at 43-48.

THE COURT: Okay. Put your next question.

Q Now, I show you an original and a copy -- the copy has been marked Plaintiff's 78, but why don't you work from the original, just confirming to me that they are copies of each other --

A They are.

Q Is that your handwriting, also?

A Yes.

Q And does your handwriting appear on the back as well?

A Yes.

Q What does this indicate? Let's see if we can't move it a little faster. The order slip indicates the sale to Bernice Grupe, does it not, of 20,000 debentures of D.W.G. Corporation five and a halfs have ninety-four sold by Lamula from its trading account?

A Right.

Q Is that correct?

A Right.

Q And it indicates, does it not, that the price at which they were sold was 54 -- that is, $540 per bond?

A Right.

Q Let's take a look at the back of these.

What does it say with respect to the quotations -- does this represent quotations obtained by you on that day?

A On the back?

Q Yes.

A Yes.

Q That's your recollection?

A Yes.

Q Do you specifically recall making those telephone calls on that day to these people?

A Yes.

Q You actually recall calling someone at Wechsler on May 23rd at about 11:07?

A Yes.

Q And you actually recall calling someone at Murphy & Durieu at 11:07 or thereabouts?

A Yes.

Q You remember that incident, although some two-and-a-half years have passed?

A My handwriting is there; that's why I remember it.

Q Is it the usual practice for you to do this, and is that refreshing your recollection, or is it because it's the usual practice that you assume that you did it? Which is it?

A I do it this way and no other way. I call them and I put my quotation on the back when I call them.

Q So that --

A Otherwise, I would have no figures on the back.

Q Do you know whom you spoke to at either of these firms?

A No.

Q Just your recollection --

A The trader.

Q Your recollection is refreshed by reading what you read on the back, that you called them and got these quotations?

A Right.

Q What's the quotation it shows with respect to Wechsler?

A 52-5.

Q 52-55?

A Right.

Q With regard to Murphy & Durieu?

A 52-5.

THE COURT: Which stock are we talking about now?

MR. BLUM: The D.W.G. debenture.

Q So those represented calls made by you?

A Yes.

Q The yellow sheets reflect no quotations at all by anybody on those days, so you just called them and asked, isn't that correct?

A I called them, yes.

Q On May 23rd, at the time that you stamped on there, you gave them a call?

A Yes.

THE COURT: Any quotes from the yellow pages?

MR. BLUM: They are devoid of quotations from anyone, your Honor, from May 21st through May 24th, and, indeed, no one quoted a price on them. The market was that thin that no one quoted a price for some period of time before and after.

MR. GOLDSTEIN: I would object to the characterization.

THE COURT: Yes. We will strike the characterization.

Q I show you the order ticket and attachment for Applied Data Research. John Lamula Investors was a market maker for this, too?

A Yes.

Q It was for all the debentures sold to Mrs. Grupe?

A Yes.

Q Would you compare that with what's marked as

Plaintiff's Exhibit 79 in evidence. They are identical, are they not?

A Yes.

Q Is this your handwriting that appears on the ticket, as well?

A It is.

Q What quotations did you obtain, to assist in fixing the price of $650 per bond for Mrs. Grupe?

MR. GOLDSTEIN: Objection. She said she did not fix the price.

MR. BLUM: I said "to assist in fixing the price."

MR. GOLDSTEIN: I withdraw the objection.

A 55-65 for Murphy, and 57-65 Wechsler.

Q Did you look at the sheets for Applied Data Research with regard to that period of time? Did you look at any sheet that had come in in the several days before, to provide any further information for fixing that price?

A I used the bond sheets for the day I make the quotes.

Q And in that bond sheet, John Lamula Investors had a bid of 55 and no ask, is that correct, do you know?

A (No response.)

Q Do you know?

A What was the question?

Q Let me withdraw the question and ask you whether it is the practice of John Lamula Investors from time to time to submit bids, by runner, for inclusion in the yellow sheets that are issued daily by the National Quotations Service?

A Repeat the question. I can't hear you.

Q Yes.

When John Lamula Investors puts bids in the yellow sheets --

A Yes.

Q -- how does it go about doing that?

A They are done the day before, the night before, and we have them ready for the man in the morning, or we make them up the first thing in the morning. We have cards.

Q A runner comes up and picks up an IBM card, doesn't he, and it goes off to the company?

A Right.

Q Do you have any part in the process in handing that card or reviewing that card or delivering that card to the runner?

A Well, sometimes I write them up, but only when I get the figures.

Q Who gives you the figures?

A Mr. Lamula.

Q On May 23rd, which was some two, three or four hours before Applied Data Research was sold to Mrs. Grupe at 65, John Lamula Investors put into the sheets a bid of 55; were you familiar with that at that time?

A I don't remember.

MR. GOLDSTEIN: I object to the statement. Miss Vena testified it could have been done the night before or sometime late in the afternoon the day before.

Q Excuse me, are those business cards made out after the close of business on one day and before business opens the next day, is that correct?

A Yes.

Q And they are picked up that very morning just before business commences, is that right?

A The time varies when they pick them up.

Q Sometime between 8 and 10 in the morning, the runner comes by and picks up that card?

A Right.

THE COURT: Is Lamula in the sheets for the following day?

MR. BLUM: No one is in the sheets for the day before or the day after. I believe no one is in the sheets except Lamula.

THE COURT: Do you have any explanation for why on a day where you started out advertising the bonds for 55 you, in fact, sold to a customer at 65?

THE WITNESS: Do I have any what?

THE COURT: Explanation.

THE WITNESS: No, I can't give you any explanation.

THE COURT: Do you have any explanation for why, although you say you called three companies with respect to Allegheny and got quotes which were roughly in the 59 area, the yellow sheets both before, on that day, and after, show that the same companies were quoting prices in the $49 range, $10 lower?

THE WITNESS: I have no explanation for their quotes, your Honor, when they give it to me at a higher price.

MR. GOLDSTEIN: Your Honor, with due respect to the Court, I think maybe your Honor's questions,and the answers, were a little misleading. I don't know if Miss Vena can answer your question. Her saying she has no explanation, may be simply because she doesn't know of any answer --not capable of giving your Honor an answer, rather than she just can't explain.

MR. BLUM: I accept your testimony. I only comment, the difference was not $10 per bond, but $100 a bond.

THE COURT: I am sorry, it was 10 in the quote but that means a hundred.

Let me suggest that, if we do this one at a time, we are going to take a couple of hours; and why don't you, right now, have the witness identify all of the quotation sheets, get that out of the way. We will be adjourning shortly. Before she comes back, she can study all of the yellow sheets and see where there are differences between the prices published and those which she says she obtained for those which John Lamula Investors advertised. Perhaps we can expedite this.

MR. BLUM: I think I can do a little better than that, your Honor. In preparation -- was it last night or the night before -- we made up a little card on each one of these, which shows Lamula's quotes, everyone else's quotes, and also the price at which they were sold to Mrs. Grupe, and also one other important piece of information and which is, when and how much Mr. Lamula acquired them before he sold them to Mrs. Grupe.

THE COURT: Does she have knowledge as to acquisition prices?

MR. BLUM: No. We established Mr. Lamula did, but he testified the writing on the ticket was hers, and that's the reason I asked for her as a witness.

THE COURT: You may give her the schedule you have prepared, but also give her the underlying evidence on which it is based, so that she has an opportunity to ascertain that the schedule accurately reflects what the exhibits indicate.

MR. BLUM: I don't think there is any problem on that. We have all those yellow sheets.

MR. GOLDSTEIN: Your Honor, as far as the blue sheets and the copies, I think Mr. Blum and I have already stipulated that they are what they are, and I think Miss Vena has identified them. We would concede the copies that he has are in her handwriting, and if called to testify, she would say that she got those quotes at the time indicated on the back and from the company indicated; and then I think if Mr. Blum wants to introduce the yellow sheets --

MR. BLUM: I think it's important, your Honor, that the jury know the apparent -- well, the differences -- I will use an unloaded term -- the differences between the prices shown as bid and asked, by the same people who are reported at different prices on the back of these sheets, one by one; but if we can do this -- I am willing to read that information in, off the ticket I have made with Mr. Goldstein, right now, if he will accept that the information which I have taken off the yellow sheets is subject to his verification over the weekend, and we can get on with it.

THE COURT: That is all well and good; but in the final analysis, this is the witness who is testifying that she got these quotations at the same time people are advertising apparently lower prices, indeed, while at the same time her own firm is advertising lower prices.

MR. BLUM: That's correct.

THE COURT: I think the witness should be asked on every occasion where this has occurred if she knows why the difference exists.

MR. BLUM: I am perfectly willing to do that, your Honor.

THE COURT: I think, first you have to establish that the differences did exist.

MR. BLUM: All right. May we proceed -- I think if we can use those cards, the information I have had -- Mr. Gold, the only information you and I haven't gone over together on them is the yellow sheets, but I listed the yellow sheets in the pre-trial last April, so

I have to assume you had an opportunity to examine them.

MR. GOLDSTEIN: Let me understand what you are going to read off.

MR. BLUM: Take a look.

(Pause.)

MR. BLUM: Let me put the order tickets, then, before the witness.

THE COURT: Look at them and see if the quotations are made out in your handwriting.

Q The Arwood Corporation ticket, is that in your handwriting?

A Yes.

THE COURT: How about Inflight?

THE WITNESS: Yes. That's my handwriting.

THE COURT: How about Knight?

Q Are the quotations in your handwriting there, too?

A Yes, that's my handwriting.

THE COURT: Look at the next one, Lincoln Mortgage.

THE WITNESS: Right. That's my handwriting.

THE COURT: And Nortek?

THE WITNESS: Yes, that's my handwriting.

THE COURT: And Technical?

THE WITNESS: That's my handwriting.

THE COURT: And Monroe?

THE WITNESS: That's mine.

THE COURT: That covers them, does it not?

MR. GOLDSTEIN: There are two Technical.

THE COURT: I understand that, but the other is a week or ten days later.

MR. GOLDSTEIN: I don't know if that's in there or not.

THE COURT: Is that in there?

MR. BLUM: If it's not, I have my copy of it and I can fish it out.

THE COURT: Are there two Technicals there?

THE WITNESS: Yes.

THE COURT: Is that your handwriting on both?

THE WITNESS: Yes, that is.

THE COURT: We are going to have to excuse the jury now, so I can go to this ceremony, and I will remind the jury, you are not due back until 12 noon on Monday, but you are due back in Courtroom 906, not here, and have a nice weekend.

(An adjournment was taken to Monday, November 1, 1976 at 12 p.m.)

BERNICE C. GRUPE

vs. 75 Civ. 2083

JOHN LAMULA INVESTORS, INC. and
JOHN J. LAMULA

November 1, 1976
12:10 p.m.

(In open court; jury present.)

THE COURT: Good morning, ladies and gentlemen.

We had a witness on the stand, I believe, when we recessed.

MR. BLUM: Mrs. Vena.

THE CLERK: You are still under oath.

MINNIE VENA, resumed.

DIRECT EXAMINATION CONTINUED

BY MR. BLUM:

Q As I recall, Miss Vena, where we had ended, Miss Vena, you had just identified each of these order slips as documents which contained your handwriting?

A I did.

Q And you identified that the writing on the back of each of these order slips was placed there by you?

A Right.

MR. BLUM: At the suggestion of the Court at the close of proceedings on Friday, I think that the Court and jury will recall the Court suggested that we prepare a summary of the information which appears in the yellow sheets on each of the days -- that is, the quotation sheets from the National Quotation Bureau -- which would also identify the sales price by Lamula to Grupe, and the quotes shown on the tickets, the order tickets -- these blue slips which were records of John Lamula Investors -- as contrasted with what was shown in the yellow sheets themselves for the days May 21, May 22, May 23 and May 24.

We have prepared those, and I have tendered a copy of that to Mr. Goldstein. You have had the yellow sheets over the weekend. Do you find this to be in order?

MR. GOLDSTEIN: Yes.

MR. BLUM: Unless there is objection, because we were not able to obtain an oak tag and prepare a larger chart, I have duplicated it and would like to offer one to the witness, which may be helpful to her, and one to each of the jurors and to the Court.

MR. GOLDSTEIN: All right.

THE COURT: Let's mark it as an exhibit, first, however.

MR. BLUM: All right. I will mark it Plaintiff's Exhibit 165.

THE COURT: This is an extract, summarizing information in the yellow sheets, concerning prices quoted on various debentures during the same period that the witness obtained telephonic quotes.

MR. BLUM: Yes. It also reflects the telephonic quotes and the prices at which the Lamula firm sold to Mrs. Grupe.

(Plaintiff's Exhibit 165 for identification received in evidence.)

x

Q Miss Vena, last Friday, you testified with regard to the first of these that you could recall making the telephone calls. Is it still your recollection with regard to each of these order tickets, that you, yourself, made the telephone call?

A I did.

Q And you can remember having made it?

A Yes.

Q And the information which you have listed there reflects what you heard on those telephone calls?

A Right.

Q And you specifically recall having done that in each instance with regard to each of these tickets and each of the indicated quotations?

A Only where my figures appeared, did I make the quotes. My figures appear on each one of them, so I made the quotes.

Q You advised us also, I think, with regard to two or three of these, that it was not you who set the price but Mr. Lamula. Was that true with regard to every one of these sales to Mrs. Grupe, that Mr. Lamula fixed the actual price at which the sale took place?

A I turned over the quote sheet to Mr. Lamula after I got them on the telephone.

Q And that was what you did here?

A I do that every day.

Q And what advice did you receive, if you can recall, from Mr. Lamula with regard to the price?

A (No response.)

Q Withdrawn.

Let me do it this way: Is it Mr. Lamula's usual practice, after surveying the notations made by you on the blue order ticket here, to inform you what price is to be entered into the books as your actual selling price?

MR. GOLDSTEIN: Your Honor, at this time, I must object as to form, because there are two Mr. Lamulas: one, the defendant in this case; and another, his brother. They both work in the same house, and I think it would be helpful to find out which Mr. Lamula we are talking about.

MR. BLUM: Thank you.

Q Let me go back one step then, Mrs. Vena, and ask: When you say that the prices were fixed by Mr. Lamula --

A Yes.

Q -- which Mr. Lamula were you referring to? John Lamula or his brother.

A Sometimes his brother, and Mr. Lamula.

Q But nobody else?

A Nobody else.

Q Either his brother or Mr. Lamula?

A Nobody else.

Q What's the brother's name?

A Louis.

Q Is Louis Lamula an employee or officer of John Lamula Investors?

A Yes.

Q Let me come back to the question I have asked.

Is it the usual practice, when you have obtained quotations, to give the order ticket together with any other information which you regard appropriate, to either John Lamula or Louis Lamula, and then to be advised by them what price has been established for the sale?

A Right.

Q Do you know whether that practice was followed with regard to these transactions, the ones which took place to Mrs. Grupe?

A Would you say that again?

Q Do you know whether the practice which you have just described was actually followed by your office with regard to the transactions represented by these blue slips?

A Yes.

Q There is one perplexing feature to me of the confirmation slips which are attached to each of those blue order tickets. Would you review all of the ones which relate to the sales which took place in May?

A Did I review them?

Q No, will you now look at them and note whether, as I observe it to be the case, the trade date, which is the date on which the transaction is calculated, and the settlement date, which I understand to be the date on which the actual change of money and securities takes place, whether the date in each instance has been corrected or altered. Is that correct?

A Altered?

Q Well, what does it show as the trade and settlement dates on the ticket which you are holding in your left hand?

A 5-23 and 5-31.

Q There is some typing over there, isn't there?

A Yes.

Q What, if you can tell us, does it say underneath the typing-over?

A I probably made a typographical error and I corrected it on my original and some of my copies.

Q I show you Plaintiff's Exhibits 2 through 11. I think there are also a couple of others there. But all the ones relating to the May transactions are there. Those are the originals, are they not, and the ones attached to the blue sheets are your office copies. Is that correct?

A Yes.

Q Now, the originals were mailed to Mrs. Grupe, weren't they?

A Right.

Q And what dates do they show as the trade date and the settlement date?

A 5-22, 6-3, and 7-10.

Q All of the May transactions show a May 22nd trade date, don't they?

A Yes.

Q When was it that you discovered this error or made this correction on your own copies? Do you recall?

Do you recall when you corrected your record copies of these sheets?

A On my personal record?

Q On the ones which are attached to the blue slips; do you recall when you made --

A When I made it? I don't recall when I made it but it may have been the end of that day.

Q You remember the telephone conversations --

A May I say something about a correction?

Q Of course.

A When I make a correction, I use Correct-to-Type.

THE COURT: Are those inked corrections in your handwriting?

THE WITNESS: Yes, these are in my handwriting. When I use Correct-to-Type, if I make an error, it only corrects the original; it never corrects the copies, because the copies have the carbon paper.

THE COURT: Which do you have there, originals or copies, or both?

THE WITNESS: These are the originals.

THE COURT: Do the originals have inked changes or not?

MR. BLUM: They show no change, your Honor. They show 5-22.

THE COURT: The explanation she is giving us is that she made a typewritten correction with the typewriter removal thing on the original, but that doesn't correct the copy, the copy had to be corrected in ink.

THE WITNESS: So it has to be corrected by hand on the copy.

Q But what I don't understand is why the originals show May 22nd.

THE COURT: Pass both of them up to me. You are confounding the confusion.

THE WITNESS: I may have made an error in the typing of them.

MR. BLUM: The originals show May 22nd, your Honor, and the file copies which are attached to the blue, show an inked over-change to May 23rd.

THE COURT: His point to you, Madam, is that there is no indication that you ever made any change in the original; the original still bears the date of the 22nd. Only the copies have been changed and they have been changed in ink.

THE WITNESS: Your Honor, when I use the Correct-to-Type, it comes out perfect.

THE COURT: I understand, but it hasn't been changed. This still has the older date of the 22nd on it.

THE WITNESS: Evidently, I caught my error after I mailed them out at the end of the day when I was listing all the transactions.

THE COURT: Which one do you mail out, the original or the copy?

THE WITNESS: I mail out the original.

THE COURT: Then you are suggesting now, that you didn't make your change until after you had mailed the original out?

THE WITNESS: Possibly, at the end of the day, when I made up my listings.

Q I show you this document, previously identified as Plaintiff's 61 in evidence, and I ask you if you can identify this, or rather, tell me what it is a copy of.

A You want me to read this to you?

Q No, I just want you to identify it. What's it a copy of?

A It is a copy of our diary sheet.

Q Does that show writing on it in your handwriting?

A Yes.

Q Would you read the entry which appears on it?

A Well, there is one for May 23rd.

Q Read that, and then read what it says below that. All of these entries are in your handwriting?

A All of it in my handwriting, yes.

Q What do they say?

A On May 23rd, okay. "M.. to correct confirmations and call Mrs. Grupe in the a.m."

I evidently made some errors and I was told, and they gave me these instructions and I put it in my diary.

Q That's your diary?

A Well, I use it, and Mr. Lamula.

Q I see.

A I take the messages and that's for Mr. Lamula or Louis.

Q Was it usual for such an entry to be made in a diary?

A No. It is not unusual for me to make these. I look at the page every day and take orders from this a lot of times.

Q And it is not unusual for you to indicate in there that you have been asked to make a correction or to telephone someone about a correction for a typographical error on some confirmation slips?

A Not unusual, no.

Q What does it say right below that?

A Friday, May 24.

Q Read it.

A "Called Mrs. G, to correct her confirmations and show the dates of 5-23 date, settlement of 5-31. She said 'Okay,' and I advised her I will correct mine, too."

Q Do you recall that telephone conversation?

A Well, I recall it after reading this, yes. I do recall it.

Q Having read that, your recollection of that conversation is refreshed?

A Right.

Q Where did you reach Mrs. Grupe on May 24th to give her this information? Where did you call her?

A Where did I call her at this time?

Q Yes.

A At this time, that was in Albany. That was the only telephone number I had.

Q I ask you to take a look again at Plaintiff's Exhibits 2 to 11 and tell me where they were addressed.

A Where they were addressed?

Q Yes, where were they addressed to?

A Lockport.

Q Lockport, New York, is that correct?

A Yes. But I never mailed them there.

Q What did you do with them?

A I mailed them to the DeWitt Hotel. That's where I was told to mail them.

Q You mailed them to DeWitt Clinton Hotel?

A Yes.

Q Although they show Lockport?

A Right. I was given this address and told to mail them to the DeWitt Hotel.

Q Who told you that?

A Mrs. Grupe.

Q When did she tell you that?

A Well, I don't remember when, but those were my instructions until further notice.

Q In the telephone conversation with her?

A Right.

THE COURT: Mr. Blum, it is apparent that the confirmations went out on May 22nd, and were dated May 22nd, and then on May 23rd the trade date was corrected to be May 23rd, at least from what the witness has just now testified.

MR. GOLDSTEIN: Your Honor, I beg to differ. The witness, I think, has testified that they went out the 23rd, with the wrong date on them, because if the sale was made the 23rd, it had to go out the 23rd, not the 22nd.

THE COURT: These are trade dates, not closing dates.

MR. GOLDSTEIN: No, trade dates. It had to go out the 23rd when the debentures were purchased. It couldn't have gone out the 22nd because nothing had happened yet. What we have here is the -- apparently what Mrs. Vena testified is that the 22nd was an incorrect date; it should have been the 23rd. If that is so, the confirmations couldn't have gone out until the 23rd.

THE COURT: Not at all, if on the 22nd she dated them the 22nd and mailed them out and didn't have the original any more, and then on the 23rd she, according to that note there, changed the date on the copies that she retained.

MR. GOLDSTEIN: No, your Honor. On the 23rd she had mistakenly put down the trade date was the 22nd, but according to the back of those blue slips the trade took place the 23rd. Therefore, they must have gone out the 23rd with the wrong date on, that the sale had taken place the 22nd.

THE COURT: In either event, and I don't think it is important at the moment, what I don't understand is why is the exact trade date important?

MR. BLUM: In our view, it connects even more closely to the dates we are coming to, which were the dates on which Mr. Lamula's company acquired --

THE COURT: Which date are you arguing in favor of, the 22nd or the 23rd?

MR. BLUM: I don't know which it is and nobody has satisfactorily enlightened me. That is why these copies of the Plaintiff's Exhibit 165 show all of the dates that I could find from May 21st through May 24th, because I didn't really know which was correct and it seemed appropriate to furnish the jury all the dates.

THE COURT: I know, but now you are going, in detail, into the changing of the date as if it is important, and I don't understand why.

MR. BLUM: If I can approach the bench, I can state the reason. I hesitate to do it with the jury present.

THE COURT: All right. Come forward.

(At the bench.)

MR. BLUM: Your Honor, I don't know whether or not some of the information that appears here is forged. I just don't know. This witness has testified, surprisingly, to me, that she specifically recalls these events. I was looking to see whether or not, in questioning her, she might or might not make some comment: she doesn't really recall which was correct. Frankly, I find it difficult to believe that over this period of time she has any precise recollection of any of this.

THE COURT: Of course, she doesn't, but it is a legal fiction when she looks at something she remembers it.

MR. GOLDSTEIN: I think that's her testimony the other day: she refreshes her recollection by looking at it.

MR. BLUM: I don't know how the numbers got that way unless they were changed deliberately after the fact.

THE COURT: The setting of the trade date was totally within the control of the defendant. If he wanted to make it a day earlier or later, he could have done it. I don't see it makes any difference if it was the 22nd or 23rd.

MR. BLUM: The proofs will show that he bought 100 of the 170 bonds he sold on May 21st or May 22nd.

THE COURT: What you are trying to show is, it could have been a day earlier and they back-dated the tickets a day earlier to argue it was not a back-to-back sale?

MR. BLUM: Yes.

THE COURT: All right. But I think you have gotten all out of this witness you are going to get.

MR. BLUM: I think you are probably right.

(In open court; jury present.)

MR. BLUM: Your Honor, again, in the interests of time, since each of the jurors has a copy of this, I don't think that there is a value in asking the witness or directing questions to the witness with regard to each of them. I only hope that -- I think we could excuse this witness at this point.

THE COURT: In the first place, he is entitled to cross-examination.

MR. BLUM: Of course.

THE COURT: Forgetting that for a moment, I do think you ought to take this thing collectively.

Does she have the 165 in front of her?

MR. BLUM: No.

THE COURT: Put it in front of her.

MR. BLUM: May I ask the Court's indulgence. Our copying machine makes only exactly the number of copies which I handed out, so I need a copy to work from.

Never mind, I have the original slips here. I can work from that.

THE COURT: In fact, I will do it for you in the hopes of expediting this.

Miss Vena, there are 12 debentures covered by Exhibit 165.

MR. BLUM: Eleven, I believe, your Honor. There are two transactions on Technical Operations and that's why, I believe, you will see 12 sheets.

THE COURT: In any event, taking these 12 transactions, as to, as I count it, the four of them, there were no yellow-sheet quotations from the two or three companies you say you called for your quotes; but on the remaining eight, at least one of the two or three companies whom you said you called and sometimes two, had yellow-sheet quotes. In every instance, the yellow-sheet quotes is substantially lower than the telephone quote that you have reported. Have you observed that, from looking through there?

THE WITNESS: Yes, I see.

THE COURT: This leaves, I would think, only two possibilities: either you recorded the telephone calls incorrectly, or they gave you telephone quotes substantially higher than they were putting in the yellow pages.

THE WITNESS: May I say something, your Honor?

THE COURT: Yes.

THE WITNESS: I see here, on the first page, 44-49

Murphy, 43-48, 42, and so on and so forth. When you called them up for a quote, I noticed many a time that they had their figures there, and then when they give me the quotes, it is 4, 5, 10 points higher one way or another, and I remark about this and say, "But you are 44-49 on the bond sheets," and they never say, "Never mind the bond sheets, this is my quote," or "Forget about the bond sheet, this is my quote."

THE COURT: You say, that is an actual occurrence?

THE WITNESS: At the time of the actual telephone call I place to them.

THE COURT: Does that happen very often with other companies?

THE WITNESS: Quite often this has happened to me, and I brought it to the attention of Mr. Lamula, and do you know what he said to me once or twice? "You didn't hear right. Call them back again." And I did call them back. And I got -- he said "You just called me. Didn't I give you 55, 60," or whatever it was; and, of course, I had to accept.

THE COURT: Doesn't the quote in the yellow sheet require them to buy or sell a certain amount of bonds?

THE WITNESS: I don't believe so, because it is an auction bond.

THE COURT: You don't think, by putting a price in the yellow sheets, they have committed themselves for any minimum of purchases?

A I can't say. All I know is, I have seen some of these prices week after week, the same price without a change, and that's why I really disregarded their prices on the sheet.

THE COURT: The fact that the prices go week after week in the yellow sheets without a change, would indicate a fairly stable market. It would make it seem rather difficult for them to say, "Yes, we are advertising this every day in the past week for a given price, but every time you call up we want a different price."

A I can't answer for them, but this is the answer I get. Of course, I have to accept these answers.

THE COURT: For example, look at Inflight Services, which is somewhere in the middle there. I think it is the fifth one. The Murphy & Durieu price, over that four-day period, never varied at all. It was always 28-30 the whole week, I think.

A Yes.

THE COURT: Yet you say, when you called them, they wanted 38-42.

A Yes.

THE COURT: And the Wechsler & Krumholz varied hardly at all. It dropped one point the last two days, but it was 28-31 for the first two, 28-30 for the second two; yet you say, when you called them, they quoted 36-41 to you.

THE WITNESS: Right.

THE COURT: How can they justify that to you?

A I can't answer your question, sir. I can't. I noticed that these investment houses deal in hundreds and hundreds of items, and I don't think they submit cards every day the way we do.

THE COURT: The problem is, they did submit cards.

A They submit them for a month and they keep the same price running, evidently.

THE COURT: But you say they won't confirm the prices when you call to place an order?

A I very seldom have gotten the same price.

THE COURT: Does that cover it, Mr. Blum?

MR. BLUM: No, sir. There is a question or two more.

Q Let's assume, Mrs. Vena, that what you say is so. Did it not seem unusual to you that in every single one of these instances of these 11 debentures on May 23rd or May 22nd, whichever it was, they quoted a price which appeared to be at the same or lower?

A No, it is not unusual.

MR. GOLDSTEIN: I would object to the question, because --

THE COURT: I sustain the objection, because I don't understand the question.

MR. GOLDSTEIN: Not only that, your Honor, the differences did not appear in every 11 issues. Sometimes, it wasn't even a quote.

THE COURT: Of the total of 12, including two for Technical Operations, four of them don't have quotes at all.

Q In every instance in which there was a quote, however, as the Court observed, the quotation which you have indicated, is higher than the quotations indicated by the firms that you noted on the back of those blue slips. At the time that you reported to either Mr. Louis Lamula or Mr. John Lamula the information so that they could price these debentures to Mrs. Grupe, did you comment on that fact to them?

A Well, I marked the sheets. I don't know if I always made a comment about it.

Q Let's ask this further question.

With regard to the Allegheny Beverage, an order ticket had been put in by John Lamula Investors on May 21st for 43-48, and on May 23rd for 42-48. Now, both of those took place before the time stamps indicated on the order ticket for Allegheny Beverage. Did it not seem to you unusual that Lamula had quoted a price only two hours earlier, that was substantially less than the quotations you had received from Wechsler & Krumholz and Murphy & Durieu?

A No.

MR. GOLDSTEIN: Again, I object to the form of the question. The testimony has been: sometimes, these quotes went in the night before -- were prepared the night before and submitted the next day, already prepared, to the service, so they weren't necessarily made two hours before.

THE COURT: But with respect to Allegheny Beverage, the yellow sheet dates are the 21st and 23rd, which is to say they were received on the 22nd and 24th, and the asking price is 48 in both instances.

MR. GOLDSTEIN: Yes, your Honor, but Mr. Blum worded his question, that these were prepared two hours before the trade date when actually they could have been prepared the night before.

MR. BLUM: They were prepared after the close of business the previous day and submitted according to the testimony we have had to National Quotations Bureau on that very morning, sometime when the runner came.

Q I again observe: Did this disparity, the difference in the price, not catch your attention at the time that you obtained these quotations from Murphy & Durieu and Wechsler and Marks? Didn't you observe it at the time?

A I accept whatever prices they give me. I take no stock of thinking about it or whatever.

Q With regard to Inflight -- and you have the sheet there on Inflight -- John Lamula Investors had submitted a bid on May 21st, at 27 bid and 33 asked, and it was in the sheets for May 23rd at 26 bid, no ask; and yet the quotations from Wechsler & Krumholz and Murphy & Durieu are substantially higher, according to your computations. Did you not observe or comment on that at the time?

A I can't remember. I don't know.

Q Did you type these confirmations that went to Mrs. Grupe?

A Yes.

Q So that at the time you typed them, you knew what price was being charged to her, didn't you?

A Well, I didn't have the quote sheets before me when I typed up these confirmations.

Q It happened later the same day.

A I just work from the blue tickets and my orders.

Q You had the blue ticket before you and it had a price on it, didn't it?

A Yes.

Q A price that had been put on by somebody, is that correct?

A Yes, I had been given the price, evidently, by someone, and put the price on the ticket.

Q On the ticket, you wrote one price; but on the yellow sheet, a few hours earlier, a bid was submitted?

A I don't use the yellow sheets when I am typing.

THE COURT: Are you aware what prices you are putting in the yellow sheets for your own company?

THE WITNESS: What is it, your Honor?

THE COURT: Are you aware of the yellow sheet prices John Lamula, Inc. advertises every day?

A When I make the cards up in the morning, I am aware of the price.

THE COURT: The point Mr. Blum is making to you is, that on about four occasions within a few hours after submitting cards at a given price, you charged Mrs. Grupe substantially higher prices?

A Yes.

THE COURT: And he is asking you: Didn't it occur to you that you were charging her more than you were listing to the public in the yellow sheets?

A I never questioned the prices given to me. I just typed them up and that was it.

THE COURT: What you say is, you do what you are told?

A Yes.

THE COURT: All right.

Q Do you recall whether there were any other transactions effected by John Lamula Investors on the date, whether it was May 22nd or May 23rd, in any of these debentures in which she sold them to anybody else?

A I don't remember.

Q Again, with regard to shorten the time, I note that there is a difference in Lincoln Mortgage Investors in which Lamula, John Lamula Investors, had a quotation in the sheets for May 22nd, which were distributed on May 23rd, of 40 and 48, a quotation which they repeated in the sheets for May 24th, yet the sales price to Mrs.

Grupe was 56. Once again, all you did was follow orders, is that correct, with regard to filling out the order tickets there?

A That what?

Q Is it correct that, even with that difference, all you did was follow orders with regard to typing up that confirmation?

A Yes.

Q And on Nortek on May 21st, you will note there is a Lamula quotation of 37-43, and a quotation on May 23rd of 44 bid, no ask. Once again, all you did was follow instructions that were given to you in filling out these forms and typing up the order tickets, is that correct?

A Yes.

Q And with regard to the sale on that day of 15,000 Technical Operations, on May 21st, there is a reflection of 68 bid, 74 asked; and on May 23rd, a reflection of 68 bid and no asked, although the sales price to Mrs. Grupe was 79. Once again, all you did was fill in the blanks as you were instructed to do so, is that correct?

A Right.

Q With the Monroe group, Lamula was bidding 50 no asked on May 22nd and May 24th; and on May 23rd, according to your information, the Monroe group was sold to Mrs. Grupe at 61. When you filled in that information, once again, you were just following orders, is that correct?

A Right.

MR. BLUM: Your Honor, I have no further questions of this witness.

THE COURT: Cross-examination.

CROSS-EXAMINATION

BY MR. GOLDSTEIN:

Q Mrs. Vena, I notice that on the rear of these blue sheets, that there is a date and a time on each sheet. How is that put there?

A When I make my first quote, I clock it in.

Q This is by a clock?

A Yes, a time clock.

Q This is an automatic time clock?

A Yes.

Q It changes the date every day by itself?

A Yes.

Q You don't change the date every day?

A I can't change it.

Q What are the dates the time clock puts on each and every one of those blue sheets?

MR. BLUM: May I ask the witness read the entire date?

A On this one, I don't have a time clock.

THE COURT: I don't understand.

MR. BLUM: You will, when she reads them.

A On this one, I don't; on this one, I don't.

Q These weren't the May ones. Let's just get the May ones.

A I think that was the time they changed the roller on our machine.

Q Here are the May blue sheets. Could you read off the dates on each one of those?

A May 23rd at 11:03, and then May 23rd at 11:07.

MR. BLUM: Your Honor, may I ask that the entire date be read?

THE COURT: Including the year, you mean?

MR. BLUM: Including the year.

THE COURT: All right, what year do they say?

THE WITNESS: The year?

MR. BLUM: Yes.

THE WITNESS: '73.

THE COURT: Well, these transactions took place in '74.

MR. BLUM: That's correct, your Honor.

THE COURT: You are pointing out that the clock had not been reset, year-wise.

MR. BLUM: It sets itself, according to the testimony we just had. I just don't know. I didn't ask the question, but I am not unhappy it's been raised.

MR. GOLDSTEIN: We will concede the year is wrong.

THE WITNESS: We have a very old machine, we recently never realized went only up to a certain year. We called the company and they said they didn't have a roller to replace it. I think we recently replaced it, maybe about four months ago or five months ago, from 1969 to '79 or something.

MR. GOLDSTEIN: Rather than read these through, will counsel concede they all say May 23rd.

MR. BLUM: I will concede they all say May 23, 1973.

MR. GOLDSTEIN: Okay.

THE COURT: Are all the times approximately the same, 11 in the morning.

MR. BLUM: They run from about 11 to 1:30 or a quarter of 2, if memory serves.

THE COURT: Okay.

Q Now, Mrs. Vena, you didn't have anything to do with setting the price that the debentures were sold to

Mrs. Grupe, did you?

MR. BLUM: Objection as to the form. I don't think it is appropriate for him to lead his own client.

THE COURT: It's been asked three times already. I don't know why it's necessary to ask it a fourth time. No, she had nothing to do with setting the price.

Q When you called up the various dealers, market makers, with regard to their price, you just took down whatever price they gave you, did you not?

A Right. Yes.

Q And you testified that on various other occasions, not necessarily with Mrs. Grupe, you had noticed a big discrepancy between the yellow sheets and what they gave you?

A Yes.

Q And on occasion, you had commented on it?

A Right.

Q Sometimes you did comment; sometimes you did not?

A No. Right.

Q But it was a fairly common occurrence; not only with Mrs. Grupe's debentures?

A Always.

Q Now, you testified that Mrs. Grupe told you to mail her confirmations of -- the May 23rd confirmations to the DeWitt Clinton Hotel?

A Yes, I had that address.

Q That's the DeWitt Clinton Hotel in Albany?

A Right.

Q That's where you mailed it?

A Yes.

Q The confirmation slips themselves give another address.

A Yes.

Q Why is the address different from where you mailed it?

A Evidently, I was told to put that address on there, but mail it to the DeWitt.

Q You specifically remember mailing it to the DeWitt?

A I had no other address to mail it to. I was told to mail it there because she was staying there or living there or what, I don't know.

THE COURT: Mrs. Vena, you had another address to mail it to--namely, the address on the confirmation sheet. The question is: Who told you not to mail it to the address on the confirmation sheets but, instead, to mail it to Albany?

THE WITNESS: The lady, Mrs. Grupe.

THE COURT: When?

THE WITNESS: Oh, evidently, around that time, your Honor, when I spoke to her on the phone. I mentioned, where to mail the confirmations.

THE COURT: Is this something you remember or something you are surmising?

THE WITNESS: No, I remember I was told to mail them to Albany.

Q Mrs. Vena, did the diary notation Mr. Blum showed you refresh your recollection as to the difference in the dates between the confirmation that you sent Mrs. Grupe and the confirmation slip that you kept? Did it refresh your recollection that there was an error?

A Yes.

Q Did it refresh your recollection that you had called Mrs. Grupe and told her about the error?

A I did.

Q Did Mrs. Grupe ever call you and complain that Mr. Lamula had sold her debentures that she had not requested him to buy?

MR. BLUM: Objection. I think this excedes the scope of proper cross-examination and more properly belongs on the defendant's affirmative side of his case.

THE COURT: Read the question back.

(Question read.)

THE COURT: We have already got in evidence, through this witness, some of the subsequent trades. I think I will allow the question.

Answer the question.

THE WITNESS: What is it?

THE COURT: The question is: Did Mrs. Grupe ever call you, complaining about Mr. Lamula making additional purchases after the first set of purchases?

THE WITNESS: No, no, your Honor.

Q She never complained?

A No.

MR. GOLDSTEIN: No further questions.

MR. BLUM: Only one question.

THE COURT: I am going to hold you to that.

MR. BLUM: I have one question that has 37 parts, your Honor.

No, seriously --

REDIRECT EXAMINATION

BY MR. BLUM:

Q Mrs. Vena, you have already identified Plaintiff's 61 as an extract from your diary, and told us that it's your practice to note something as apparently minor as the process of telephoning a customer and telling them that something was misdated.

Now, where in your diary or anywhere else, if you can recall, did you note the instructions which you say Mrs. Grupe gave you as to where to mail the confirmations? Is that in the diary?

A I put it in my diary.

Q Is there anything in your diary where you noted down, "Mrs. G says, please mail my confirmations not to my Williamsville home, but to the DeWitt Clinton"?

A I probably got it on the telephone and didn't put it in the diary. Anything I had to do specifically with a correction, I put in the diary so I don't lose the information I got.

Q But so far as you can recall, you never wrote down anywhere, what address you were told to send confirmation slips?

A I don't remember. I don't recall.

MR. BLUM: No further questions.

A I know I was getting the calls from Albany, and I asked where to mail it, and I was told to mail it up here, to Albany, so I did so.

THE COURT: You are excused.

THE COURT: Do you want to keep the witness here in the event you want to call her or is she done?

MR. GOLDSTEIN: I will call her.

THE COURT: Do you want her to remain?

MR. GOLDSTEIN: That, I will have to work out with the witness, your Honor.

THE COURT: All right. Call your next witness.

MR. BLUM: John Lamula.

JOHN J. LAMULA, a defendant called as a witness by the plaintiff, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BLUM:

Q Mr. Lamula, you are one of the defendants here, are you not?

A Yes.

Q You are the president of John Lamula Investors, the other defendant, is that correct?

A Yes.

Q I am going to, again in the interests of expediting this procedure, I would like to read into the record from the agreed facts as stated in the pre-trial order which was signed by this Court in May of 1976, certain information with regard to the purchases, by John Lamula Investors, of the debentures which were subsequently sold to Mrs. Grupe. I think it may expedite matters if there are any records of John Lamula Investors, with which you care to follow this, so that you can confirm or disagree if there is anything in that pre-trial order which is incorrect.

MR. GOLDSTEIN: Your Honor, for reasons previously stated, I must object, and I would ask that either we have a conference at the bench so I can state my objections, or that the jury be excused for a couple of minutes so that I can put my objections on the record and have a ruling from the Court on this.

THE COURT: All right, we will excuse the jury for five or ten minutes.

(Jury excused.)

(In open court; jury not present.)

MR. BLUM: Your Honor, before this application commences, may I ask that Mrs. Vena be excused, since there appears to be a possibility that she might be called again as a witness?

THE COURT: Yes, if she's being called later, you better ask her to wait outside.

(Witness excused.)

MR. GOLDSTEIN: Your Honor, just for the record, I would ask Mr. Blum to indicate what sections of the pre-trial order he intended to read, so that we can definitely identify what the motion would be in reference to.

MR. BLUM: Yes, your Honor. I believe it is Paragraph 11 of the pre-trial order, which tracks admissions which were made by Mr. Goldstein in response to the request to admit.

THE COURT: It is not just 11; it's 11 through --

MR. BLUM: It begins at 11 and runs consecutively from there through the foot of page 13, with one addition which Mr. Goldstein and I have stipulated to, and that is that the chart which appears at Item 23 on the foot of page 13 should be labeled "John Lamula Investors Gross Profit."

THE COURT: Do you intend to go through all the transactions in the stock or only those which occurred in May?

MR. BLUM: It is my intent to show the assembly of whatever inventory there was on each of the transactions. Some of them, you will see, refer only to May, because the entire inventory was acquired in May.

THE COURT: I understand. But with regard to Allegheny, he purchased 46 in early April, but he sold 35 in mid-April. What purpose would be served by tracking all of that?

MR. BLUM: It will show there were no other transactions, which to my mind is a very important thing. This was terribly thin. Because his books, which we examined in his deposition, show no trades of any kind, either way, except these.

THE COURT: You are proving these things, not solely for the purpose of attempting to establish that he charged a higher price than he should have, but also to establish the thinness of the market in which he was working?

MR. BLUM: Exactly, your Honor, for both purposes.

MR. GOLDSTEIN: I think, also, he is trying to prove that Mr. Lamula purposely acquired an inventory for the purpose of reselling to Mrs. Grupe, later, at enormous profits. Isn't that so?

MR. BLUM: Yes. He was addressing himself to markup. I am doing it for both purposes. The testimony will show the first meeting was around March 21st, and by the time this inventory started to be collected, our contention is: Mr. Lamula knew pretty well he was in control of the situation and began when cash developed, to pull together an inventory that he could work with.

THE COURT: The great number of purchases are on the 29th of May, which is a day or two before the closing date of the transactions.

MR. BLUM: I think they relate to May 21st or 22nd as the trade date. These are all settlement dates. That's about 100 now of them, I think, your Honor.

THE COURT: Yes. Your objection, as I understand it, is that unless it is a back-to-back transaction, he can properly charge anything he wants to and that the profit he makes is immaterial?

MR. GOLDSTEIN: Not charge anything he wants to. What I am saying is, unless it is -- I would even go further and say, it is the same day; but let's stick with Mr. Rowney who said, sometimes overnight he would consider a riskless transaction.

My contention is that any other transaction, days before or weeks before or even in some of these cases months before, is not a riskless transaction.

THE COURT: I will agree with you that "months before,"certainly isn't. However, he is not putting "months before" in for purposes necessarily of proving this transaction; he is also trying to prove the thinness of the market.

MR. GOLDSTEIN: But the main purpose Mr. Blum is trying to bring out is that Mr. Lamula found himself

Mrs. Grupe. He knew he was going to sell her securities. He went around purposely getting an inventory ready for this one sale.

MR. BLUM: That's right.

MR. GOLDSTEIN: My contention is, to buy these stocks in April or early May, is totally irrelevant, because Mr. Rowney, himself, stated there is volatility in this, the prices themselves, in the yellow sheets show volatility.

THE COURT: Very possibly you are right for April and early May, but that is something we will have to charge the jury on later. What we are talking about now is admissibility in evidence, and I think the purposes of showing the thinness of the market as well as the general flavor of the overall transaction, he should be allowed to prove all these you stipulated to.

I suspect I will charge the jury that the prices he paid, certainly in April, do not create a riskless transaction as to which he is controlled as to his margin.

MR. GOLDSTEIN: Your Honor, but it would be greatly prejudicial. The jury , as you well know, is not sophisticated in this case. If they see figures well below and they see he made a big profit on this, they are not going to consider, in their mind, he may have taken a chance at the time he bought them in April or May, that the market was going to go up. They are not going to look at that. They are going to look at the final sum and see what profit he made.

MR. BLUM: 130 of these 170 bonds or 180 bonds all together, were either bought on the day of or within two days before the date, assuming it was May 23rd and not May 22nd.

THE COURT: The only ones as to which there is any substantial purchases outside this week or so, is Alleghany Beverage --

MR. BLUM: And even there, it picked up 20 on --

THE COURT:--and D. W. G. Corporation, and at least on Allegheny he purchased for just slightly more, about three or four points more in the period we are dealing with, so there is no tremendous difference in the price there.

There is one other trade in April and that is Applied Data Research. Again, the price is not that widely different. I will allow it. It's close enough for the purpose of being put in.

MR. GOLDSTEIN: Especially with Allegheny, these are settlement dates, which means the actual purchase took place in March with Allegheny; and Mrs. Grupe, herself, testified she did not tell him to buy this, nothing was finalized, until sometime in May. So Mr. Lamula would have to know back in March, probably even before he even met her, that he was going to meet her and make this sale, or in April, that she was going to agree to this.

THE COURT: I will tell you what we will do. Since he bought 36,000 in early April, and he sold 35,000 in mid-April, we will rule out as being irrelevant, the first two Allegheny purchases.

MR. BLUM: This will create one problem for me, and that is, the only thing you are ruling out are these two.

Do we have a magic marker or can I block them out?

THE COURT: You can cross them out.

MR. BLUM: The gross-profit figure is a stipulated gross-profit figure.

MR. GOLDSTEIN: Yes. Except if we take out those figures --

MR. BLUM: It doesn't affect gross profit. You have conceded that is what his gross profit was. But your argument is, as to this 36,000 here, and he bought 20 more, which made 46,000; and sold 35, so he had 11. What you are saying is addressed to damages, and if we are going to submit special interrogatories to the jury, the time to deal with that is when you submit damages, the damage interrogatories to the jury if they return a verdict against your client.

THE COURT: You gentlemen are having a colloquy with each other. Let's not bother keeping this on the record. Excuse me for a moment and decide how you want to handle this.

I would say, black out those first two.

(Recess.)

(In open court; jury present.)

THE COURT: Ladies and gentlemen, I think we have arrived at a stipulation which will save considerable time in going over these records.

The parties have agreed that Exhibit 152, which is set up in front of you, correctly sets forth the acquisition of the debentures involved, by the defendants giving the cost paid, the profit; and where it says "date acquired," that means the date of settlement, which is usually about a week after the trade date. They allow about a week from the time you place the order until the time you actually receive the papers. And the "date acquired," represents the delivery date of the debentures, rather than the date on which they were ordered.

Is that correct, gentlemen?

MR. GOLDSTEIN: Also, that's gross profit, not net profit.

THE COURT: And that's gross profit and not net profit. Otherwise, it's so stipulated.

MR. GOLDSTEIN: Yes.

MR. BLUM: Yes, your Honor.

THE COURT: The witness may resume the stand.

JOHN J. LAMULA, resumed.

BY MR. BLUM:

Q So, then, if I can just refer very briefly to one important feature on Exhibit 152, Mr. Lamula, you acknowledge that on settlement date of May 29th, which means a trade date of May 21st or May 22nd, you acquired 20,000 Allegheny Beverage debentures, 20,000 Arwood debentures, 20,000 Inflight Services debentures, 5,000 Knight Industries debentures, 19,000 Lincoln Mortgage debentures, 25,000 Nortek debentures, 15,000 Technical Operations debentures, --

A Excuse me, counsel. I need some other records and I think I need the beginning of your question again.

Q We can do it one by one, if you wish.

A We can, as soon as I get my records.

Q Can we use this, Mr. Lamula, which was stipulated to. We can use this, can we not? Why don't you come over here and we can use this, which was stipulated to, so I don't have to keep swinging it back and forth.

I just wanted to establish the correctness of this in the jury's mind.

THE COURT: Why establish the correctness to something that has already been stipulated.

MR. BLUM: Because the date is of particular significance, your Honor.

Q The ones which are indicated May 29th, which is 20,000 Allegheny, or May 28th or May 30th, 20,000 Arwood, 20,000 Inflight, 5,000 Knight, 19,000 Lincoln, --

A On Allegheny Beverage, what's your contention?

Q My question is, they were bought on a settlement date of the 29th, which means they were bought a trade date of a week or eight days earlier, is that correct?

A Settlement date of May 29th, that is correct.

Q Which means a trade date of about a week or eight days earlier?

A Right.

Q And D.W.G., again all of these reflect the discussions we had at the deposition, Mr. Lamula, and I think your counsel has conceded their accuracy.

Skipping the D.W.G., move down to the ones which seem more pertinent, time-wise -- Arwood, May 28th settlement date.

A What date do you have?

Q May 28th settlement date.

A Yes.

Q Inflight, May 29th settlement date, 20,000?

A May 29th, 20,000.

Q Knight, 5,000 on May 29th?

A May 29th, 5,000.

Q Lincoln Mortgage, you bought 19,000 on May 29th, which means actually, the transaction occurred some week or eight days earlier?

A 19,000, May 29th.

Q Nortek 20,000 on May 29th?

A Yes.

Q Technical Operations on May 29th, there was 15,000 that you acquired, which means that the trade date was about a week or eight days earlier. And then there were 6,000 more which you acquired on June 3rd?

A May 29th, 15,000. And June 3rd, 6. June 27th, 3.

Q And on Monroe, 5,000 on May 29th?

A Correct.

Q And Elco on July 6th. I think that is in error. I think the Elco date is June 6th.

THE COURT: June 6th is correct.

Q This is in error. June 6th you acquired the Elco?

A We bought 13 on June 6.

Q There were others we talked about, but let's --

A Do you want the Applied?

Q I think we have a stipulation on the record that all of these reflect the acquisition dates that are shown in your records. Is that correct?

A Where does the acquisition date show on here, sir?

Q There is a blank on that because it was not legible at the time we deposed you.

THE COURT: Perhaps he can read it now.

A 10,000 on April 8th at 53.

Q When was the next 10,000?

A May 10.

Q Am I correct in my understanding, that on May 29th -- withdrawn -- that the only transaction shown on the Allegheny sheet, if you refer to that, Mr. Lamula, -- do you have it before you?

A I have.

Q The only transactions engaged in by your firm with respect to Allegheny Beverage from April 10th to

May 29th were the purchase of debentures on April 10th, the sale of 35,000 on April 19th, and the purchase of another 20,000 on May 29th, is that correct?

A There were a number of purchases before May 29th.

Q Yes.

A There were purchases in April --

Q April 2 and April 4 and April 10?

A Yes.

Q And the sale on April 19th. And the next transaction was May 29th, when you bought 20 more, is that correct?

A That's correct.

Q And then two days later, according to cur records, you sold 30,000 to Mrs. Grupe. Is that correct?

A That is correct.

Q And that left you with an inventory of one, is that correct? I think that's right. Or was there any inventory left?

A Our next purchase was June 17th.

Q Was there any inventory left after the sale to Mrs. Grupe?

A No.

Q With regard to D.W.G --

A There was one bond left.

Q There was one left?

A Right. We had a total of 31 at that time.

Q Right, and you sold 30, so there was one left?

A We had some purchased in April and some purchased in May.

Q Correct.

Now, with regard to D.W.G., do you have those sheets before you?

A Yes, I have.

Q Were there any transactions in D.W.G., after you bought 20,000 on April 2nd and before you sold 20,000 to Mrs. Grupe on May 31st?

A I am sorry, I have another trading sheet involving the stock of D.W.G., and that's what I am putting aside. We did trade that, also.

Q 20,000 bought April 2nd, 20,000 sold to Mrs. Grupe May 31st, and no transactions in between. Is that correct?

A I am sorry. Would you repeat the question, sir?

Q Yes.

20,000 bought April 2nd, 20,000 sold to Mrs. Grupe May 31st, and no transactions in between. Is that correct?

A From April to May.

Q Is that correct? Between April 2nd and May 31st, no transactions?

A No. There were transactions before that.

Q I say, from April 2nd to May 31st, there were no transactions?

A There were transactions before that and after that.

Q Were there any transactions between April 2nd and May 31st?

A No.

You heard the answer.

Q No, I didn't, because you were speaking at the time I was asking the question. What was the answer?

A The answer is no.

Q Thank you.

With regard to Applied Data, 10,000 bought on April 8th -- I am sorry, do you have the sheet before you on Applied Data?

A I am looking at it now.

Q Am I correct: There were 10,000 bought April 8th, and 10,000 bought May 10th, and 20,000 sold to Mrs. Grupe on May 31st, and no transactions in between. Is that correct?

A No, but there were purchases in July, two purchases in July.

Q Is it correct that --

A There were two purchases in July.

Q Is it correct there were no transactions from April 8th to May 31st, other than the purchase of the 20,000 and the sale of the 20,000?

A Yes.

Q Now, with regard to Arwood, on May 28th -- withdrawn. On May 27th, did you have any inventory in Arwood?

A Prior to May 29th, we had inventory on April 2nd.

Q On May 27th, did you have any inventory in Arwood?

A No.

Q On May 28th, did you buy 20,000 -- you bought 20,000, and on May 31st you sold 30,000 to Mrs. Grupe?

A That's true.

Q Were there any other transactions across those four days?

A No, the 20,000.

Q Now, on May 29th, you have told us you bought 20,000 of Inflight, and on May 31st, 20,000 of Inflight were sold to Mrs. Grupe. Were there any other transactions across the days: May 29th, May 30th, or May 31st?

A Would you repeat the purchase date, sir.

Q Yes. On May 29th you said that 20,000 Inflight was bought. Correct?

A 20,000 Inflight purchased?

Q Was purchased by you on May 29th.

A No. No.

Q What does your record show?

A May 22nd.

Q That was your trade date.

A That's the settlement date.

Q The settlement date was May 22nd on Inflight?

A Right.

Q Was there any inventory on May 21st?

A No.

Q And on May 31st you sold the 20,000 that were bought on May 22nd, you say, to Mrs. Grupe, is that correct?

A (No response.)

Q There weren't any transactions in between the time you bought those bonds and sold them to Mrs. Grupe, were there, Mr. Lamula?

A We had a transaction on May 23rd of four bonds sold at 45. We had a transaction on May 24th of three bonds sold at 46.

THE COURT: Which debenture are you talking about?

THE WITNESS: We are talking about Inflight, your Honor.

Q I would like to see that sheet, Mr. Lamula. Would you hand it to me, please.

A I'll give it to you in a minute.

THE COURT: Let me point out to you, there are stipulated facts.

THE WITNESS: No, your Honor, I was looking at '73.

THE COURT: The wrong year?

THE WITNESS: Yes.

Q Let's look at '74, then.

A We are at '74.

Q All right. We are talking Inflight, 1974, and my question is: Is it correct that you had no inventory at the commencement of business on May 29th?

A We had inventory as of May 29th.

Q On May 29th you bought 20,000, correct?

A That is correct.

Q And on May 31st you sold 20,000 to Mrs. Grupe, correct?

A That is correct.

Q And in between, there were no other transactions, is that correct?

A In between what dates?

Q In between May 29th and May 31st.

A No, no transactions.

Q Now, with regard to Knight Industries, at the close of business May 28th, did you have any inventory?

A No.

Q And on May 29th you bought 5,000, correct?

A Yes.

Q And on May 31st, sold 5,000 to Mrs. Grupe; is that also correct?

A That is correct.

Q In between, there were no other transactions --

A That is correct.

Q -- with Lincoln Mortgage Investors on May 29th -- withdrawn.

At the close of business on May 28th, is it correct that you had an inventory of 1,000, one bond?

A No.

Q What inventory did you have at the close of business May 28th?

A 2500.

Q You had 2500. And on May 29th you bought 19,000 more, is that correct?

A That's correct.

Q And on May 31st, you sold 20,000 to Mrs. Grupe, correct?

A That is correct.

Q And no transactions between the purchase of the 19 and the sale of the 20, correct?

A The purchase of what date, sir?

Q Of the 19 and the sale of the 20. There were no other transactions in between, is that correct?

A In the two days, no.

Q With regard to Nortek, what inventory did you have on May 28th?

A Settlement of May 29th, we purchased 20 bonds.

Q There was no inventory at the time you made that purchase, correct?

A No.

Q On May 30th you sold 5,000 to someone else, correct, other than Mrs. Grupe?

A That is correct.

Q And on May 31st, you sold the remaining 15 to Mrs. Grupe, is that correct?

A That's correct.

Q With regard to -- let's skip over the -- well, as long as you have the Technical Operations -- I am sorry, that's Nortek.

Technical Operations, what inventory did you have on May 28th?

A None.

Q And on May 29th you purchased 15,000, is that correct?

A We purchased 15,000, that's correct.

Q And on May 31st, 15,000 were sold by you to Mrs. Grupe, is that correct?

A That's correct.

Q And there were no transactions in between?

A In between May 29th and May 31st?

Q That's correct.

A No. In between May 29th and May 31st, --

Q Between that purchase and sale, were there any other transactions?

A Between the two days, no.

Q When did you next acquire any Technical Operations debentures?

A June 3rd and June 27th.

Q June 3rd you bought 6,000?

A Yes.

Q And on June 10th you sold 5,000 to Mrs. Grupe?

A That is correct.

Q Any transactions between June 3rd and June 10th?

A Between June 3rd and 10th, no.

Q Monroe group, on May 29th, you bought 5,000, is that correct?

A We bought 5,000 on May 29th.

Q And you had no inventory at the time you made that purchase, correct?

A No, we had inventory earlier that month, but not before May 29th.

Q And you sold the 5,000 which you had bought, two days later to Mrs. Grupe, is that correct?

A That's correct.

Q No transactions in between?

A In the two days, no.

Q With regard to Elco, you bought 15,000 on June 6th, is that correct?

A Would you repeat that date, sir?

Q June 6th. I think you told us just a little while --

A We had 3,000 in inventory and we bought 13,000 more.

Q 13,000 more on June 6th?

A Yes. Above the three.

Q And on July 17th you sold 10,000 to Mrs. Grupe, correct?

A That is correct.

Q And you acquired no others in the interval, is that correct?

A No, not until July 1st.

Q Mr. Lamula, do you have the income tax return for John Lamula Investors filed for the year 1974?

A Yes.

MR. GOLDSTEIN: While Mr. Lamula is looking for it, can we approach the bench?

THE COURT: Yes.

(At the bench.)

MR. GOLDSTEIN: On this, I am going to object to any testimony about his income tax return, the firm's income tax return, on the grounds it is irrelevant.

THE COURT: I don't know where we are going, so I can't rule on it.

MR. BLUM: One of my duties is to establish scienter, and I am looking to establish the firm was in desperate financial straits and this was their biggest mark of the year. It adds weight to the jury's understanding of the scheme and manipulation.

MR. GOLDSTEIN: Assuming, which I am not, but for the sake of argument, this was his biggest trade of the year, so what?

THE COURT: I think it has some evidentiary value, but I don't think you have to put the tax returns in for this purpose. Simply refer to them to the extent necessary to refresh his recollection. Confine yourself to total gross profit for the year, to the number of transactions, and so on, to do it.

MR. GOLDSTEIN: Your Honor, I would object to that question, also. In the interest of saving time, et cetera, can I make any objection now?

THE COURT: Yes, go ahead.

(In open court; jury present.)

Q Mr. Lamula, with the documents in your hand, which you have, can you tell us what was the gross profit of John Lamula Investors for the year 1974?

Perhaps I can rephrase it.

Was the business profitable that year?

A If you have it on your return --

Q I have never seen this document.

A You subpoenaed this document. You have a copy of it.

Q No, sir, I did not.

THE COURT: In any event, can you pick the gross profit out of that?

THE WITNESS: I am trying to find it.

MR. BLUM: I have never seen that document before. We subpoenaed it one trial date ago.

THE WITNESS: This was many months ago.

MR. BLUM: I have the forms filed with the SEC, but I don't have the tax return.

Q Mr. Lamula, do you recall whether the firm made a profit that year?

MR. GOLDSTEIN: I think there are about three questions on the record.

THE COURT: There are.

MR. BLUM: There are none being answered. That's why I keep asking it in different forms.

THE COURT: The gross-profit figure has to be on a corporate tax return.

How about gross sales? Do you have gross sales and cost of sales?

MR. BLUM: I do not have those figures.

Are you asking me?

THE COURT: I am asking Mr. Lamula.

A I have a figure of commission income and recovery and dividend income that aggregates some 22,000. Our net line at the bottom, after all deductions of salaries and rent and other expenses, show a loss of slightly over $100,000.

THE COURT: Would the 10,000 or 11,000 profit made on these sales be reflected in the commission figure of 22,000?

THE WITNESS: It would be reflected in the gross-profit figure.

THE COURT: Which you make out to be a total of about 22,000?

MR. GOLDSTEIN: Your Honor, I believe he was talking about net profit when he said the 22,000.

MR. BLUM: I believe not. I thought he said the gross commissions and dividends and interest came to that number, Mr. Goldstein, but again, I have't seen this document.

THE WITNESS: I believe a subpoena was issued for our accountant and we will be glad to have him back here. He did come. There are a batch of papers --

MR. BLUM: He appeared in the court on Friday morning and I asked Mr. Goldstein to collect that document from him so I could use it today. That's what I am interested in.

Q Can you tell from that? If not, I would be pleased to examine it, if I may, since the witness has referred to it and evidently can't get that number. Perhaps counsel and I can agree and the Court can state what the number is.

THE COURT: Why don't you set it aside. When we have a recess around 3 o'clock, you can look at it then. I am assuming you will still be examining Mr. Lamula about 3 o'clock.

MR. BLUM: Not I. I don't think I will be examining him for more than another question or two.

THE COURT: All right. Then after whatever cross there is, we will take a recess and attempt to establish that, if we can, without wasting any more time.

THE WITNESS: Your Honor, there are work sheets that go with these papers; and our accountant, who was subpoenaed, could be here on very short notice.

THE COURT: I don't think we are going to have him back. Continue, Mr. Blum.

MR. BLUM: One moment, your Honor. I may have no further questions for this witness. I would like to review my notes for just one second.

(Pause.)

MR. BLUM: I have no further questions for this witness.

THE COURT: Cross-examination?

MR. GOLDSTEIN: No questions.

THE COURT: Why don't we take a brief recess and the two of you look over that tax return and see if you can agree what was the gross profit for the firm for the year. If you can, that may save us a little time.

We will take a brief recess.

(In open court; jury not present.)

THE COURT: The plaintiff is putting in evidence two additional documents that come in without objection. Is that correct?

MR. BLUM: That is correct. We will do that when the jury is here. They have already been marked as 166 and 167.

THE COURT: The plaintiff rests at this time?

MR. BLUM: With the admission of these, your Honor, the plaintiff rests.

THE COURT: The defendant has a motion?

MR. GOLDSTEIN: Yes, your Honor.

Your Honor, at this time the defendant moves to dismiss the complaint, and for judgment in favor of the defendant against the plaintiff, on the following ground:

The first ground covers the complaint alleging common-law fraud. As our brief indicates, there are six elements, each one of which must be present for recovery in favor of plaintiff. The absence of any one of those elements means that plaintiff's case must, as a matter of law, be dismissed.

The first is, representation of material fact to plaintiff. What was represented? Plaintiff admitted that she wanted an income of $12,000 a year. Defendant said, "Fine, these are the debentures, and I can give you the 12,000 or approximately. These are what you can invest in."

There is no question that the investment satisfied plaintiff's needs as far as that point is concerned.

There is no question that she received the income as and when it was supposed to be due. She testified to that. She received each and every dividend check that was supposed to be due.

There was no representation made, for instance, that "You are guaranteed to win on this, you can't lose. It's guaranteed to go up." There was no such representation. The only representations were: "These debentures will give you the income that you want. I recommend them," period.

Therefore, there was no misrepresentation to the plaintiff.

THE COURT: Let's short-circuit this a bit.

I would agree with you, the lack of suitability of the stock would not make a common-law fraud claim. However, I do not think the common-law fraud has to be an affirmative misrepresentation. It can also be the failure to state material facts which the person knows, and I take it that the strongest part of the plaintiff's case in that regard is the alleged failure of the defendants to reveal to the plaintiff that they were making a market and that they were purchasing debentures, particularly for purposes of selling them to her at a profit. And while I am not certain at the present time whether that is adequate for common-law fraud, because I haven't read the many cases cited by Mr. Blum, I don't believe you cited any cases at all in that regard, --

MR. GOLDSTEIN: No, your Honor.

THE COURT:--that's the area in which the fraud resides, if any.

MR. GOLDSTEIN: Your Honor, assuming, for the sake of argument, that that is entirely true, it still does not bear on the question of what plaintiff wanted and what defendant gave her. She wanted certain income. He gave her that income with these debentures. I think, the question of whether or not he made a profit, a huge profit, a small profit, whether he took a loss or not, is immaterial, and irrelevant, for the question of representation.

THE COURT: If she indicated that, in addition to wanting the income stated, she also wanted high-grade securities; if in fact he sold her securities that were not high grade, and if in the course of doing it he withheld from her the fact that he was a market maker and therefore could make a substantial profit on the sale; and if his motive in concealing these things was, in order to make this sale, it is possible you have a common-law fraud. I have not reached a final decision on it. I am going to have to read the case cited first.

MR. GOLDSTEIN: Your Honor, according to my recollection the plaintiff never discussed high-grade securities or low-grade securities. In fact, her testimony was, she didn't know anything about it. Therefore, the only thing that she did discuss was, she did not want stocks and he didn't give her any stocks. Therefore, there wasn't any misrepresentation on that one point.

THE COURT: I think she testified she wanted quality things. I can't recall her exact words, but my recollection of her testimony is that she indicatd she wanted safe investments. So I am reserving decision on the common-law fraud claim.

MR. GOLDSTEIN: I will have to pursue the rest of that, your Honor, because there are several points in common-law fraud.

THE COURT: What are the other points?

MR. GOLDSTEIN: The representation being false.

THE COURT: I have already told you that I don't see any affirmative false representation vis-a-vis the common-law fraud. It is a question of whether the withholding of certain facts constitute it.

MR. GOLDSTEIN: We skip to reliance. In this case, plaintiff has to show she relied on what defendants said.

Plaintiff's testimony was, in May she found out her nephew was in the stock-brokerage business. In addition, she had an attorney for a son, which attorney had at one time directed her to L.F. Rothschild. One other further thing. As testimony later recounts, she had spoken to her sister and brother-in-law and could have relied on these people at that time. Therefore, the reliance factor is simply not there. She had other people she could turn to.

THE COURT: I think reliance is there. I think what you are establishing is, considering the other contacts she had available to her, it was imprudent simply to rely upon what he was telling her; but her evidence is, she did rely on him, she did not talk to the nephew broker about the value of the stock until after the purchase.

MR. GOLDSTEIN: The next point to be proven is whether plaintiff acted with prudence, considering the fact she had a son who advised her earlier about investments.

THE COURT: She testified, he didn't know anything about investments.

MR. GOLDSTEIN: Finally, assuming plaintiff has proven everything up to now, and proven that there were false representations, she still has to prove that they were the proximate cause of her injury.

In this respect, she testified that she ordered L.F. Rothschild to sell these securities for her. That was her testimony. She directed them to sell them for whatever they could get.

There was testimony that August and July were very volatile months. President Nixon was on the point of either going to trial for impeachment or resigning.

I respectfully submit that the time these debentures were sold was clearly fortuitous; and, in addition, the very fact that she sold them, does not show that any losses she sustained was the result of misrepresentations by the defendant, because there was also testimony that some of these issues did well after that; that July and August, again, were particularly volatile months, and if they had been sold, say, a month or two later, there wouldn't have been a loss.

THE COURT: Perhaps, and if we had gone through an impeachment proceeding, the market might have fallen further. I don't agree with you on that point, although you are entitled to prove she didn't mitigate her damages as well as she could have, but that's a different point.

MR. GOLDSTEIN: My point there is that the damages do not necessarily flow from the misrepresentations, if there were any.

As far as statutory fraud, as per the cases that we cited, material facts had to be misrepresented to the plaintiff.

In addition, there had to be intentional or recklessly negligent misrepresentation. Erroneous statements cannot form the basis of statutory fraud, and I refer the Court to the cases cited in my brief.

While it is true, common-law elements are not controlling in a statutory case, they are still considered to be guidelines as per the Second Circuit in the SEC vs. Manor Nursing Home case.

I don't think that they have shown that there were intentional misrepresentations here. Therefore, I think --

THE COURT: Again, you are relying on affirmative misrepresentations as opposed to withholdings.

The place I have the most difficulty with the plaintiff's case is plaintiff's heavy reliance upon the NASD rules of fair practice, which to my recollection, have not been placed in evidence.

MR. GOLDSTEIN: That was my next point, your Honor. All the evidence points to violations of NASD, SEC, et cetera.

Plaintiff, I think, has testified with relation to what she did. She claimed she was an unsophisticated woman, did not have any knowledge, et cetera. I think it stretches the imagination when she says she went to the library and checked these things up without having any background and based solely on that she hastened to New York without securing professional advice or any other kind of advice, and she has testified that she did not rely on knowledge of any NASD rules or SEC rules and there has been no testimony as far as I remember, about what those regulations are.

THE COURT: That means, for purposes of charging the jury, I can make no references to them, but I think mdlm 250

there is adequate reference to the record to support a plaintiff's verdict for fraud under the securities law. I deny your motion in that regard.

Does that do it?

MR. GOLDSTEIN: That's it, your Honor.

THE COURT: All right. Bring the jury back in.

(Recess.)

MR. BLUM: With regard to your ruling, first as respects the NASD rules, my understanding is that courts have traditionally regarded them, as recently as two years ago, where the circuit court said in Colonial against Bache that results, whether rules of the Exchange or NASD rules, which were adopted pursuant and in accordance with directions contained, as I understand it, under Section 15A of the 1934 Act, in instances where they are clearly intended to protect the investor, be given the force of law.

For the purpose of the bringing of a private action for civil liability under the Securities Act, in that regard I respectfully urge your Honor to review the proofs which have been submitted in light of the rulings made in those cases.

THE COURT: You are talking of apples and oranges. Even assuming that they have such effect in the industry that a violation of the rules is the equivalent of a violation of the law, you still have to prove what the rules are, and you have't done that. So whether they are treated merely as an industry standard or as something being binding upon all people dealing in securities, they still have to be in evidence before they can be considered, and at present they are not in evidence. This is not to say, however, that in considering a securities fraud or a common-law fraud, the jury may not evaluate suitability on their own, but I can't charge them on the NASD rules unless they are in evidence.

Bring the jury in.

MR. BLUM: I have a second point to what I was saying, your Honor. I was concerned about your Honor's expression, also, with respect to suitability, not only by reason of this question of the NASD rules which may be supplemented in the course of examinations which follow, but also with respect to the question of suitability generally. I think that there has been a great deal of testimony by Mr. Rowney as to what's customary in the securities industry with regard to the understanding of what's suitable for an investor situated as Mrs. Grupe was situated.

THE COURT: That's what I said. There was sufficient evidence for the jury to consider that issue.

MR. GOLDSTEIN: There is one other point to my motion I neglected to raise, and that is, I request the Court to dismiss any action concerning improper markup since there was absolutely no testimony that any markups in here were improper. In fact, I don't even know if the jury was given a definition of what "markup" was. But there was definitely no testimony as to improper markups.

MR. BLUM: That is entirely a question of law. We have established what the markup was and how the securities were priced, and I think it is then for the Court to charge and the jury to decide with respect to whether or not the markup that was taken under the circumstances here was a permissible markup or whether it was excessive, as an element of the fraud.

THE COURT: I think there is a jury issue on it. The jury issue, to some degree, may revolve around whether you accept the 22nd as being the true date rather than the 23rd, because then you have got in effect an overnight transaction.

MR. GOLDSTEIN: Except, your Honor, the definition of markup is: "what you add on as a commission or your profit onto a matter; not the difference between what you buy it for, put it into inventory and then sell it." I believe Mr. Rowney himself said, "Ordinarily there is nothing wrong in that." It isn't even called a "markup." It's just, if you are lucky you make a profit; if you are not lucky, you make a loss. That isn't a markup. There's been no testimony as to what a markup is.

THE COURT: I am not certain that we have a cause of action labeled "markup," do we?

MR. BLUM: There is a count marking "excessive markup." I think every element of that count has been shown, every single element.

MR. GOLDSTEIN: Nobody testified as to how it is determined whether it is excessive or not excessive.

MR. BLUM: That is a question to be reserved as a matter of law.

THE COURT: I will reserve decision on that.

Bring in the jury, please.

MR. BLUM: Your Honor will read in the profit and loss numbers and I will make the tender of the document, and we are done.

THE COURT: Yes.

(In open court; jury present.)

THE COURT: We have attempted during the recess, ladies and gentlemen, to determine the corporation's gross profit for the year. This is quite difficult to do because the corporation had income, both from commissions in underwritings and other things, and also had income, or as the case may be, loss, on its trades from the securities it held.

The figure which Mr. Lamula gave you, of something less than $22,000, was the total income from commissions, underwritings, and selling group, whatever the word "group" means. However, that figure would not appear to have anything to do with the trade involved in this case because there are no figures large enough in any point of time to cover it.

There are two other columns, however: One is "Gain on Stocks," and one is "Loss on Stocks." For the month of May, 1974, it shows a gain in stocks of $11,403.73, and we assume that that includes the transaction involved in this case.

For the year, however, the total again on stocks, was $108,687.73. However, for the year the total loss on stocks was $159,409.58, with the result that the overall picture for the year was a loss on stocks; and I think when it says "stocks," it includes debentures -- can we agree on that?

MR. GOLDSTEIN: Yes, your Honor.

MR. BLUM: I think that's right.

THE COURT: -- in excess of $50,000.

Consequently, there was no gross profit for the year, much less a net profit.

Have I correctly stated the figures as shown in the work sheets?

MR. BLUM: Yes, your Honor.

MR. GOLDSTEIN: Yes, your Honor.

THE COURT: All right.

You have, also, put in evidence two additional documents. Do you want to show them to the jury?

MR. BLUM: I would like to.

The jury will recall that on Friday the Court, again in the interest of saving some time, with respect to market prices, on the time that the debentures were sold by Mrs. Grupe through L. F. Rothschild in August, it established what the bid and asked, appearing in the yellow sheets, were at that time. We prepared some tabulations, and we have marked that in evidence as Plaintiff's Exhibit 66, sheet by sheet -- I mean, security by security.

Again, with the Court's consent, I will hand out a copy of each of those which during the course of the remainder of the afternoon, you may wish to examine. Each of these sheets shows what L.F. Rothschild sold the debentures for, and also, what the quotations were in the yellow sheets at that time.

In addition, there were two of these debentures, Nortek and D.W.G. Corporation, for which no quotations were available, and we have and are offering as an exhibit, with the approval of counsel for defendants, a letter from the National Quotation Bureau, which is the company that prints out the yellow sheets and assembles them, showing that there were, with regard to Nortek, no quotations of any kind between July 18th and September 18th. And on D.W.G. Corporation, that there were no quotations of any kind in the sheets from April 30, 1974 to December 31, 1974.

I will give this to the jury, also, which supplements the others.

With that proffer of evidence, your Honor, the plaintiff rests.

THE COURT: All right.

I have already heard from the defendant on its motions. Consequently, we can now proceed to the defendant's case.

MR. GOLDSTEIN: Defendants call Mr. Lamula as their first witness.

THE CLERK: Remember, sir, that you are still under oath.

JOHN J. LAMULA, a defendant called as a witness in his own behalf, having been previously sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. GOLDSTEIN:

Q Mr. Lamula, can you give us your educational background?

A I have a B.S. and an L.O.B. from Southern Law School in Athens, Georgia.

Q Do you have a law degree?

A Yes, I do.

Q After finishing law school, what did you do?

A I came to New York. I met a man by the name of LaGuardia, who offered me a position on his staff as a research man.

Q And this was Mayor LaGuardia?

A Mayor LaGuardia. My first position was on the staff of Mayor LaGuardia.

Q What was that position?

A I was probably the 10th or 11th secretary, but being given various chores investigating various letters that came in, talking to people who had problems, and acting as a factotum, accompanying the mayor to his weekly broadcasts every Sunday and doing other chores for him.

MR. BLUM: Your Honor, again, Mr. Lamula's history is an interesting one. I am familiar with it. But I'm not sure that it is relevant, and I object to this line of questioning unless it can be connected in some way with the issues which are brought forward in this case.

THE COURT: We will allow a little latitude to give background, but let's not make this into a "This is Your Life" program.

Q To speed things up, Mr. Lamula, can you give us some highlights of your life, say between 1940 and 1974.

A In '42, I was elected a member of the legislature from lower Manhattan. I wrote the first rent control bill in '43, the commercial rent control laws in '44, and I worked on the anti-discrimination law --

MR. BLUM: Your Honor, if I may, I think this self-parading of Mr. Lamula's good works, which I will be the first to concede, is not what is at issue in this case; but rather, what his experience is in regard to the transactions at issue.

MR. GOLDSTEIN: Just as Mrs. Grupe's background was important, I think it is important for the jury to understand Mr. Lamula's.

THE COURT: I think it is adequate for him to give us the years he was in the legislature without accomplishing his legislative accomplishments. I realize tomorrow is Election Day, and we have been hearing about accomplishments, perhaps too much so; but let's concentrate on those which have to do with his knowledge of securities and his expertise as a securities dealer.

What years were you in the legislature?

THE WITNESS: '43 and '44.

THE COURT: Did you hold any other positions in the legislature?

THE WITNESS: Yes.

Q What were they?

A Around 1958 to 1965, deputy clerk and assistant to the officer of the assembly.

From 1966 to '72, as an assistant to the majority leader of the state senate.

From that time to the present, I am a consultant to the Senate Finance Committee.

THE COURT: Continue.

Q Assistant to the Senate Finance Committee. Is that a paying job?

A Yes, it is.

Q How much do you get?

A $7800 a year.

Q Do you also get expenses?

A No. I pay my own expenses in Albany. And I pay my own travel expenses.

Q Do you know approximately what your expenses come to in a year just for your legislative duties?

MR. BLUM: Let's have a time frame. It may be relevant.

Q For 1974.

A Some 2- to $3,000.

Q What are your duties with regard to the Senate Finance Committee?

A I work on specific legislation that is either assigned to me or by way of agreement, either in reviewing the background of the appointees of the governor, or in initiating legislation. As a specific, if you wish one piece of legislation that was initiated this year and hasn't been completed yet is, how to get 60,000 to 70,000 more uniformed men on the streets; namely, by passing legislation to provide that all uniformed members of all forces: police, fire, sanitation, and also the police who work at the banks, travel to and from work in uniform. This would give us 60- to 70,000 more uniformed men riding the subways, walking the streets, the ferries, and the busses.

Q Did you also have something to do with legislation regarding the securities business?

A Yes, one of the great problems in Wall Street is stolen securities -- messengers, people who work in back offices. The issue of stolen securities amounts to hundreds of millions of dollars a year. In many cases, they are not reported to the police because we have no legislation that requires that they be reported to the police, although the brokerage firm or the bank that has missing securities will report these to their insurance company.

The legislation that I have written this year and on which --

MR. BLUM: Objection. We are talking about 1976.

THE COURT: Let's confine ourselves to things up to 1974.

THE WITNESS: We started in 1974.

Q In 1974, did you hold any elective offices?

A No, I held the same position which is when I started on the legislation that I am talking about.

Q When did you start advising people as to investments in securities, et cetera?

A I'm sorry.

Q When did you first start advising people -- not necessarily through a business, but advising people as to what investments might be proper for them?

A 20 to 25 years ago.

Q I see.

And when did you start John Lamula Investors?

A In '57; 20 years.

Q What's John Lamula Investors?

A John Lamula Investors are brokers, traders, and underwriters.

Q Let's take the first term.

What do you mean by "broker"?

A When we act in the capacity of a broker, we execute an order given to us by a customer on a commission basis.

Q And what about a "trader"?

A A trader is a firm, and all firms from Wall Street are traders. This includes Merrill Lynch, Bache, and including the firm represented by the expert here. All firms are traders. They buy and sell other securities for their inventory account. They are ready to buy and sell from other brokers or to the public. But these are securities that go into their account and come out of their account.

Q What about "underwriters"?

A Underwriting has to do with the issue of new stock or additional stock of an existing company. If there is a large block of stock to be sold, either in a company that is going public for the first time -- this would not necessarily mean a new company. One company, as an example, called "P.V." which you may not recognize, has been in business for a hundred years, but they decided to go public for the first time some several years ago.

Now, that is underwriting. If we participate in the underwriting, we agree to buy two or three thousand shares or some set figure, and then we try to sell that stock to clients.

Now, Merrill Lynch does the same thing, and Bache does the same thing, and every other brokerage house does the same thing.

Q Have you ever been involved in any underwritings with Merrill Lynch?

A Yes.

Q And Bache?

A Yes.

Q And other large, well-known Wall Street firms?

A And Shearson Hammill and several hundred Wall

Street firms. We have been involved in some 200 underwritings over the past 15 or 16 years.

Q During the history of your firm, have either you or your firm ever been reprimanded by either the NASD or the SEC?

A No.

Q Have you ever had any disciplinary actions brought against you by either of those bodies?

A No.

Q You were here when Mr. Rowney testified, were you not?

A Yes.

Q He used the term "junk bonds." Do you agree with his definition of what a junk bond is?

A Yes.

Ladies and gentlemen, a junk bond --

MR. BLUM: Objection, your Honor. The witness answered the question.

THE COURT: Yes.

Put your next question.

Q You agreed with his definition?

A A junk bond --

Q No, Mr. Lamula, the question is: Did you agree with Mr. Rowney's definition?

A Definitely not.

Q I thought you misunderstood?

A I am sorry, I did misunderstand.

THE COURT: You said you did, but you don't.

THE WITNESS: I didn't understand the question. My hearing is not good.

Q So the answer is, you did not?

A Definitely not.

Q What is your definition of a junk bond?

A The term "junk bond" came into existence many years ago, and it referred to those bonds of companies that went into bankruptcy, that were rated below "D." When they didn't pay the interest any more, they became junk bonds. This is the term used in Wall Street for the bonds or the debentures of any company that does not pay interest, may be in Chapter 11 in bankruptcy or Chapter 10 in liquidation; and these are the bonds that are definitely known as "junk bonds." Not any bond or debenture in which the interest is currently being paid.

Q Does that also refer to securities of foreign countries, that term?

A Yes.

Q Can you give us examples of that?

A As a matter of fact, there are many people who are still buying Russian bonds. One could buy a thousand dollar bond for perhaps $20. You could buy a Polish bond for $50. One could buy a bond of Grants, which went into bankruptcy, perhaps for $20. The hope is -- and there are people who do buy these bonds, and they are highly intelligent people who buy these bonds, on the theory that in the reorganization, something will come out for the bondholder, and if they could buy a thousand dollar bond for $20 or $30, they will buy these bonds; and some very astute people do this and they find in the long run, they do make a profit, but it's not for the unsophisticated It has to do with very, very sophisticated people who know they are gambling, but who are in effect gambling what they believe is a small amount of money for a potentia recovery in the reorganization of the company.

Q Is the definition you gave of "junk bond" the one that is prevalently used in the securities business?

A Yes, very definitely; and it applies to all bonds, as I wish to repeat, where the interest has been passed, where they are not paying it, and where they may be in reorganization under Chapter 10 or perhaps in liquida tion under -- in reorganization under Chapter 10 or in liquidation or some reorganization.

Q The term "market maker" has come up. Can you give us your definition of market maker?

A A market maker is a broker. Merrill Lynch, Bache, all of the leading brokerage firms, including our own small firm, in which we are ready to buy and sell certain securities. In our case certain debentures. In the case of Merrill Lynch, some two or three hundred stocks are traded as market makers, where they buy and sell for their own account.

For example, if I may give one, American Express is bought and sold by Merrill Lynch for their own account, and if a customer wants to buy American Express, they will sell a lot of inventory.

A company called "Tampax" is bought and sold over the counter, and these firms have it in their inventory and we have had it from time to time. We also deal, occasionally, in a few stocks.

But a market maker consists of practically every single firm in Wall Street who, over and above taking your order to buy 20 shares of American Telephone and charging you a commission, also make markets in debentures in which we make markets, and they also make markets on a number of stocks.

For example, Mr. Blum's expert was here, and I have a list. Their company makes a market in some 300 debentures and some 300 different stocks where they buy and sell for their own account. There is one warrant on their list that shows 1/8 - 1/2. They are willing to buy it for 1/8 and they will sell it for 1/2. That's a difference of 300 percent.

Q Now, going to Mr. Rowney's company, you have researched for this trial some of the companies that his company is a market maker in, have you not?

A Yes, I have.

Q Are there substantial triple C companies that his company is a market maker for?

A Yes, there are.

MR. BLUM: I don't understand where this line of questioning is headed.

THE COURT: I don't, either.

Anyway, the question was improperly worded. Reword it.

Q Does Mr. Rowney's firm deal in triple C rated companies, as rated by Standard & Poor's and Moody's?

A Yes.

THE COURT: I think he so testified, as a matter of fact.

MR. BLUM: I believe he did. I will concede Drexel Burnham is one of the largest bond tradings houses in Wall Street and makes market. If the number is 300, I will accept that. I don't understand what the line of questioning is, but in order to get on with it, I will concede it.

THE COURT: It was appropriate cross-examination of the witness when he was here and it was done at that time, as I recall. I don't know why we are going back over it again.

Q You mentioned American Express. That is traded on the over-the-counter market?

A Yes.

Q Do you know what their rating is?

A There is no rating.

Q They are not rated?

A No.

Q What about Occidental Petroleum?

A Occidental Petroleum is rated "B" in the same way some of our issues are rated "B."

Q What's the gross sales volume of Occidental Petroleum annually?

A Between 4,000,000,000 and 5,000,000,000.

Q We have gone over Standard & Poor's and Moody's. Do you agree with their rating system?

A Absolutely not.

Q Do you think their rating system is valid at all times?

A I have absolutely no confidence in their rating system and I devised my own rating system on a theory of checking into special situations, analyzing the companies, checking with the officers, looking at their volume, their profit, and, what's terribly important, the amount of debentures that are outstanding.

Q Mr. Lamula, are you aware of how Standard & Poor's and Moody's rates companies?

MR. BLUM: Can we get that question? I object to the form of it, your Honor.

Q Are you aware of the way Moody's and Standard & Poor's goes about rating companies?

THE COURT: Don't use the word "aware." Use the word "Do you know how they rate companies."

A In two ways.

MR. BLUM: What's the answer? Is the question: Does he know how they do it?

Q Do you know how they go about rating companies? Yes or no.

A Yes.

Q Okay.

Now, first of all, does a company have to pay a fee to Standard & Poor's or Moody's if they want to be rated?

A Standard & Poor charges fees from 500 up to 15,000 to rate a company. In some instances, they may have to rate companies because there is such a demand from their clients -- namely brokerage houses and banks -- that they may do it for a lesser fee in order to get the figures. But Standard & Poor is interested in rating those issues for which there is great demand for background.

Obviously, a security like Occidental Petroleum, since we mentioned that--that does 4- to $5,000,000 -- would be one in which many of the brokerage firms who subscribe to Standard & Poor, and the banks, and the investment trusts, and the pension plans, would want information on, so Standard & Poor would make every effort to get that information, even if they were not paid the full amount.

But in other instances, they charge a fee in order for a company to be rated, and that fee ranges up to $15,000 a year.

Q Now, does Standard & Poor's and Moody's have subscribers to their lists?

A Yes.

Q Who generally are these subscribers?

A The overwhelming number of subscribers are the major brokerage firms who may have two to three to four hundred subscriptions for their various offices and their various officials and their various branches, the banks, the pension plans, the investment trusts, and some individuals.

Q Could you tell us approximately, in round numbers, how many companies are traded on the over-the-counter market, New York Stock Exchange and American Stock Exchange?

A On the New York Stock Exchange there are approximately 1800 companies. On the American Stock Exchange there are approximately 1200 companies. On the over-the-counter market, there are some 20- to 24,000 companies.

Q Are each one of these companies rated by Standard & Poor's or Moody's?

A They have attempted to rate them. In many instances, they have no rating. In a great many number of cases, there are no ratings or there is just a blank line, but there are some that they have rated. There are many that they have rated.

Q In a case where there is a blank line next to their name in Standard & Poor's or Moody's, what does that signify?

A That the company in question does not wish to give Standard & Poor's all the information they want and they put a blank line saying that they don't have sufficient information available.

Q What does the term "not rated" next to their name mean?

A That Standard & Poor has no rating for that company and basically they are not able to get the information they want or the company doesn't want to be rated and refuses to discuss it with them.

Q I see.

Mr. Rowney stated, banks, as a policy, buy these companies; is that true?

A In some cases.

Q In some cases they are rated?

A It may be.

Q So it is not an overall policy?

A It is a policy in the main. Banks do not want Standard & Poor to tell anybody else how they should be rated.

Q Did there come a time in 1974, you met Mrs. Grupe for the first time?

A Yes.

Q Do you know approximately when that was?

A The middle or third week of March.

Q How did that meeting come about?

A Miss Emerson, who is a lady that I have known for many, many years and helped me in the legislature and had some investments in our office, called me to tell me she had a friend who was interested in getting information about investments and had a problem about income, and would I spend an evening with them to discuss this lady's problems or answer some of the questions this lady might have.

Q Approximately how long have you known Miss Emerson?

A Since 1938.

Q Approximately how old is she now?

A 77.

Q Do you have any information as to her current health condition?

A She is seriously ill and has been in bed for the last ten days. She has a serious case of arthritis and has recently gotten pneumonia and has been in bed, but when she does get around she probably weighs about 85 pounds now and she needs two crutches to get around.

Q Where does she live?

A In Cayuga, New York, which is near Auburn, New York.

Q And that is up around Ithaca, is it not?

A Right.

Q During the time that you knew Miss Emerson, say up to 1974, was she working for the state in any capacity?

A Yes. Miss Emerson was in charge of the stenographic pool for the state senate for a number of years, and before that, was in charge of other undertakings in the assembly or in general other parts of the legislature, but in recent years she has been in charge of the stenographic pool consisting of some 40 or 50 people who were under her supervision.

Q By the way, prior to 1974, had you been married?

A Had I been married?

Q Yes.

A My wife died in March of 1973.

Q And how long had you been married?

A Thirty years.

Q So that at the time you met Mrs. Grupe, you were a widower?

A Yes.

Q Do you know approximately when the first time you met Mrs. Grupe was?

A I am sorry?

Q What week in March, when you first met Mrs. Grupe?

A About the second -- about the middle of March or the third week of March.

Q Where did this meeting take place?

A In Miss Emerson's apartment, as arranged.

Q To clarify matters, weren't all subsequent meetings, between March and the end of May, in Miss Emerson's apartment?

A Every single one except on a few occasions, on two or three occasions I may have met Mrs. Grupe for five minutes in Miss Emerson's office, passing by, where we might have had a cup of coffee with three or four people.

Q Miss Emerson was present at all of these meetings that took place at her apartment?

A Yes.

Q Do you know the substance of the first conversation you had with Mrs. Grupe?

A Yes.

Q Could you tell us, generally, the substance of what you said and what she said?

A After the first five or ten minutes of socializing, Mrs. Grupe said she had a problem. She had a certificate of deposit for $100,000 on which she was receiving 8 percent, and had been advised by the bank that upon expiration, the return would be reduced to 7 percent; and she said, "I need more than that to live on and I would like some advice."

Q At that time, did she tell you when the certificate of deposit would expire, would come due?

A Yes, I asked.

Q What did she tell you?

A July 15, 1974.

Q By the way, what time of day did you meet Mrs. Grupe?

A In the evening after dinner.

Q Was it on any special day of the week?

A Most times it would be on a Tuesday. That would be a more leisurely time. Monday is a hectic day in Albany, and Tuesday evenings and Wednesday evenings are slightly less hectic.

Q Were you up at Albany during this period of time, between March and May, every day of the week?

A No, approximately two to three days. Most often, two nights and three days, but it would vary depending upon how heavy the work was in the legislature.

Q Did most of these meetings take place Tuesday night?

A Most of them took place on Tuesday evening.

Q Approximately how many meetings were there in all?

A We met practically every single Tuesday from the first meeting through May, except for one period in April when there was a ten-day recess, and at that point, the meeting was two weeks apart, but all told there were a minimum of eight to nine to ten meetings.

Q Was anything else discussed at this first meeting outside of the certificate of deposit?

A Yes.

Q What else?

A Mrs. Grupe said that she had learned from Miss Emerson that I had invested some money for Miss Emerson; that Miss Emerson had done well and was satisfied and happy, and would I consider making some investments for her.

Q Had you, in fact, made investments for Miss Emerson?

A I beg pardon?

Q Had you, in fact, previously made investments for Miss Emerson?

A Yes. Quite a number of the issues Mrs. Grupe had, Miss Emerson had purchased prior thereto and still has them.

Q Did Mrs. Grupe tell you at the first meeting the source of the $100,000?

A I don't believe so. I did learn from Mrs. Grupe, perhaps the second or third meeting, because at that time I didn't want to ask many questions.

Q Had Mrs. Grupe mentioned at this first meeting what her income requirements would be?

A She did say one of the reasons she could not or would not renew with the bank was that she needed approximately a thousand dollars a month to live on, and since she wasn't sure of the income that she would be getting from the legislature, since the position might be a temporary one, that she was hoping to invest this money so that she might get at least a thousand a month.

Q Did she tell you at this first meeting her other sources of income?

A Yes. Just that she had income from the legislature--naturally, her salary there -- and that she had some reserve money above the $100,000.

Q Did she tell you approximately how much at that time?

A Not at that time.

Q Did she subsequently tell you?

A Yes.

Q And what was that?

A That she could invest -- my question -- by the second meeting or the third meeting, I began to ask many questions. I wanted to know a lot more about her background, and I asked her what other reserves she had; and at that point, she said she had sufficient reserves; that she had 20- or $25,000, I believe, in one savings account, and then another account; and she did have -- she did tell me she gave her son $11,000, and that her son was an attorney.

I raised the question and asked: did she have a will. I said, "I have to ask you these questions because I would like to know as much about your background as possible." She said, "Yes, I do have a will."

I said, "Who is your executor, if I may ask?" She said, "My son, the attorney."

"Could I ask you who the beneficiaries are?" She said, "My three sons."

I said, "I would like you to discuss anything you plan to do with your son who is the attorney." And she said, "No, no, no, I won't have anything like that."

I said, "Give me his name and address and telephone number and the name of his law firm, so I may have it as of record." She said,"I don't want him to know anything about my affairs. I just gave him $11,000."

I said, "Bea, aren't you concerned about being unfair to your other children if you gave him $11,000?" She said, "That was to buy him a house."

I said, "That's still a problem you are creating for yourself." "No," she said, "I received a note. My son gave me a note for $11,000; so it's, in effect, a loan."

Q So, she indicated to you, there were two bank accounts, at least?

A Yes.

Q Did she indicate to you that she owned any other securities?

A That she had taken a fling on some oil item and told her broker, "Just put it into something for me," and spent $500 for it.

Q Were those her words, "taken a fling"?

A Yes.

Q Did she tell you about any other investments, such as real estate, that she had made?

A Well, she had a lot she had bought in Florida at the rate of $10 a week, which was fully paid for; and that she had a house in Buffalo, or outside of Buffalo.

Q Did she tell you how much that house outside of

Buffalo was worth?

A I don't believe I asked that question at that time, though it did come up later.

Q Mr. Lamula, let me ask you this question.

You spoke to Mrs. Grupe. She said she wanted an income of a thousand dollars a month. Why all these questions? Why didn't you just go out and buy her some securities that would pay her a thousand dollars a month?

A I was meeting Mrs. Grupe as a friend. I didn't think of it as a business relationship. As a matter of fact, I said "Bea, we deal in convertible debentures. Our firm buys and sells them. These are some of the securities that Dorothy has."

She said, "The one thing, I don't want any stock. Don't buy me any stock. I know what happened with my family in the crash"; and I said, "No, we don't buy stock except occasionally for ourselves or where people specifically ask for it, and they are stocks that we think are quality." I said, "If we got an order from a client who wanted to buy a stock at $1 a share in Canada, we would not take the order; we would have that man go somewheres else. If we got an order from a client who wanted to buy a hundred shares of International Telephone, we would take the order."

But she was adamant about not wanting stock, and I then began to explain what debentures were, but I said "I will be bringing you some report which I will review with you."

Q Mr. Lamula, if after you had spent all this time with Mrs. Grupe she said, "Thank you very much, but I am not interested," what would your bill to her have been?

A Absolutely nothing.

MR. BLUM: Objection, your Honor.

THE COURT: Overruled.

A Absolutely nothing.

As a matter of fact, after the third or fourth meeting, when Mrs. Grupe began to understand the debentures that I had explained, I suggested that she buy them through her own broker in Buffalo.

MR. BLUM: Objection, and move to strike the part "began to understand" and everything that follows.

THE COURT: That was volunteered, and will be stricken, and the jury will disregard it.

Q Did there come a time, during your meetings with Mrs. Grupe, you suggested to her she look to someone else to purchase securities for her?

MR. BLUM: Objection. He is leading the witness.

I want to get through this in a hurry, but there is a limit to how many words he can put in his mouth.

THE COURT: Just tell us about your discussions with Mrs. Grupe in the purchase of securities. What further discussions did you have with her about purchasing securities?

A About the fourth or fifth occasion on which we were discussing securities, these would be on successive weeks, except for the one week that was skipped sometime in April, I said to Mrs. Grupe, "Bea, you have a broker in Buffalo; you know someone in Buffalo?" She said "Yes."

I said, "Why don't you let me call him? You can buy these securities in Buffalo. I will explain to your broker exactly why I am recommending these issues and buy them through your own broker."

Mrs. Grupe's answer to me was, "I don't want anybody in Buffalo to know my business, and I don't want anybody in my family to know my business, and I would rather do business with you."

Q Now, if she had taken your advice, what would your commission on any sale have been?

A None.

Q You wouldn't have gotten any money?

A No. If she had taken my advice and she had given me the name of her broker in Buffalo, I would have discussed the issues with the broker in Buffalo and he would have put through the transactions.

Q Now, Mr. Rowney testified yesterday that as an investment adviser he takes one-half of one percent as his fee. Do you also charge an investment fee?

A No, we make a practice not to charge that fee, whether we buy securities for a client or not. We don't believe that fee is proper for a broker to also receive an investment fee. There is nothing improper. We just prefer not to do it.

Q During these several meetings, eight, nine, whatever the number is, did Mrs. Grupe ever mention ratings?

A Yes.

Q Do you know approximately what meeting this was brought up?

A Perhaps, the second.

Q What did she say with regard to ratings?

A She said, "Are these debentures that you propose to buy for me or that you are going to recommend, A ratings?" And I said, "Bea, I couldn't follow the ABC ratings of the rating organizations. I study a company, I make a special situation of it, and I give it my own rating. I am not influenced by the rating of these organizations because over the years I have found a considerable degree of shortcoming and too many people are swung by these ratings, which are not substantial, in my opinion."

Q Now, prior to her mentioning, her bringing up this question of ratings, had you ever mentioned it to her at any prior meeting?

A As to rating?

Q Rating.

A No.

Q So the first mention of any rating was by Mrs. Grupe to you.

MR. BLUM: Objection. I think there is sufficient testimony by the witness, without Mr. Goldstein giving testimony.

THE COURT: Yes. He said "No," and that answer is that.

Q Now, do you remember the approximate meeting when specific securities were first mentioned? By "specific," I mean names, like the name of a company.

MR. BLUM: Objection. It hasn't been established that there was ever a meeting when specific names were mentioned.

THE COURT: Overruled. Your client testified:

names were mentioned, but she couldn't remember them.

MR. BLUM: "May have been mentioned" is what, I believe, she testified.

THE COURT: Did there come a time specific names were mentioned?

THE WITNESS: Yes.

THE COURT: When?

THE WITNESS: After the first meeting: the second, the third, fourth, fifth, sixth, seventh. After the first meeting, on the second occasion, I brought several annual reports with me and at that meeting I said, "These are some of the securities we deal in. Now, let me explain these to you."

I moved my chair alongside of her chair, and I said "Technical Operation is in the following business," and went down the line to show the nature of the business.

Q Mr. Lamula, before we get to that, did there come a time when you explained to Mrs. Grupe what the term "convertible debenture" was?

A Yes.

Q When, approximately, was that?

A On the very first occasion, I said "A convertible debenture is a loan to a company. You are not a stockholder. You are lending Technical Operation or Arwood $1,000, except that we are able to buy that $1,000 debenture for $800 or $750; but it's a loan, it's an obligation that must be paid back, and the company must pay the interest on the due dates. It's not like stock. The bonds will fluctuate but not as greatly as stock. But holding them to maturity, you must receive a thousand dollars for each debenture that you buy without regard to the cost now, and you must receive the interest every six months. The interest will be known to you in advance, and you will know exactly how much you are to receive from each one of these companies every six months."

This was a way of making definite:

Number one, that a debenture is a loan.

Number two, that the interest is fixed and must be paid twice a year.

Number three, that there is an expiration date by which time, if they haven't called it in before, by which time you will get the thousand dollars.

For example, Technical Operation expires in 1985. The entire debenture loan of this company was $4,000,000 and the company does $100,000,000 a year in volume, and it's a profitable company; and they have radio stations in Buffalo, and in Boston; they have construction companies, and they are in electronics. Their volume is

100,000,000; they are profitable, and the debenture issue is only 4,000,000.

But in addition to that, in the original contract it's provided that beginning in 1976, February 1976, the company must buy in 8 percent of the debentures every year. That means that last February, they bought in $320,000. By this February, they must buy in $320,000 more. Each year, they must buy in 8 percent.

And I explained to Mrs. Grupe, I said "Bea, you may not have to wait until 1985 to get your thousand dollars. By 1983, '82, or '81, the company may not be able to buy them in the market. Then they will pull numbers out of a hat. Then you are compelled to sell your bond to the company, but for a thousand dollars."

Q Now, Mr. Lamula, mention was made the other day by Mr. Rowney about stock dividends and the interest payments on the bonds. Was it possible for any of these companies to pay its stockholders a dividend and omit the interest on the bonds?

A Absolutely not.

Q Why?

A Absolute not, because the bond or debenture is a prior lien, and they must pay the interest. There were many companies--Consolidated Edison is an example. When

Consolidated Edison got into difficulty, they passed the dividend on their stock, on the common stock, but they had a preferred stock on which they paid the dividend; and they paid the interest on all of their bonds and debentures, and they have about 30 different bond issues, but all interest has been paid on the Consolidated Edison debentures, and the Consolidated Edison bonds.

Q Isn't it true they are required to pay the interest by a certain date on the debentures?

A Yes, there is a specific date. For example, Technical Operation, the interest is payable on F and A 1. F means February 1st, and August 1st, exactly six months apart. If you have $10,000 of Technical Operation, no matter what price you paid for them, whether you paid $790, as Mrs. Grupe paid, or some people -- my father-in-law paid $920 for them, or some other people bought them for less when the market got bad -- you still get $800 a year for $10,000 in debentures. You get $400 on February 1st, and $400 on August 1st. You are sure of your income.

Q Could the board of directors of, say, Allegheny, decide at a board meeting that this year they are not going to pay interest on the convertible debentures without any legal repercussions?

A Impossible. They would be, in effect, courting

Chapter 11. The debenture holders -- I would be one of the first ones to start a Chapter 11 proceeding. But using Allegheny as an example, they have two classes of preferred stock on which they are paying a dividend, and the debentures come before the preferred stock and before the common stock.

Q Now, could this same board of directors of Allegheny say, "This year, we are not paying a dividend on the common stock?"

A Yes.

Q And there would be no legal repercussions from that?

A No. This is one of the dangers that, in fairness to Mrs. Grupe, she wanted to avoid -- namely, the fact that she was making an investment for income; and I recognized that danger, and it's one of the reasons we were dealing in stocks over the years. But back around 1967 or '68, we decided to shift to debentures because I wanted to make sure that our clients were certain of receiving the income.

Q In other words, there is no requirement that a stockholder receive a dividend in any given year?

A No.

MR. BLUM: Again, your Honor, I am not trying to get in the way of his leading his witness, because I don't mind where he is going --

THE COURT: It is not the leading aspect. He got the answer from the witness, but he is reciting it in his own words. Why don't we save a bit of that for the end of the trial.

Right now, we will take a brief recess.

(Recess.)

(In open court; jury present.)

DIRECT EXAMINATION CONTINUED

BY MR. GOLDSTEIN:

Q Mr. Lamula, in his testimony, Mr. Rowney, in discussing Monroe, alluded to a bankruptcy or Chapter 11. Did Monroe, in fact, go into Chapter 11?

A They did.

Q When was this?

A Sometime last year.

Q In 1975?

A The latter part of '74 or the early part of '75.

Q Did they subsequently come out of Chapter 11?

A Yes.

Q Are they still in existence today?

A Yes, the company is operating.

Q Are they paying interest on their debentures?

A No, the debentures--as part of the settlement, the debentures have been exchanged for a preferred stock. For each $10 of debenture, there would be one preferred stock paying 7 -- one preferred share, paying 7-7/8ths percent, which was -- or a dividend equivalent to that amount, which was an interest on that debenture.

MR. BLUM: I think we have had some of this discussion before, but I would like to register an objection, on the grounds of relevancy to testimony, as to the current status of these securities.

THE COURT: I think you opened the door as to Monroe, because you raised the fact Monroe had gone into receivership. I thought you were going to object to the fact that he was stating equivalent of interest on bonds to dividends on stock, when dividends on stock are not guaranteed.

MR. BLUM: No, the comment I would make, your Honor, if I recall, as Mr. Lamula just said, they went into Chapter 11 at the end of 1974, which is really within the time frame your Honor thought might be irrelevant. When we start what is happening with the Chapter 11 reorganization at this point, I suggest that and other data about these companies is beyond relevance as to whether they were a good investment in 1974.

THE COURT: As to the others maybe, but I will allow it.

Q Subsequent to 1974, did any of these other companies file for Chapter 11 or go into bankruptcy?

A No, they are all doing very well and all paying the interest.

Q Now, Mr. Rowney mentioned -- I believe it was Allegheny and the SEC?

A Yes.

Q Are you familiar with that action?

A Yes, I am.

Q Do you know the outcome of that action?

A The president of the company, a man by the name of Lapidus, decided to bring the action to a close by agreeing to put $600,000 into the company. Since he is a major stockholder, in describing it to me he said, "I'm just doing this. I'm a major stockholder. My family are stockholders. We don't want to waste any more time. If they disagree on our accounting procedure, we will put the money into the company."

Q Is that what the action was about: accounting procedure?

A Yes.

Q And it's now been disposed of?

A That was disposed of some time ago.

Q In May 1974, when you sold these debentures to Mrs. Grupe, were you familiar with each and every company?

A Yes.

Q Were you familiar, also, with Elco, which you sold to her in July?

A Very much.

Q You say "familiar." Did you know more than just their names and what they did?

A I knew the name of the company; I knew some of the officers; I knew what they did; and I also knew that just at about that time, there were several other companies that were trying to buy Elco. This was a matter of public record. There had been flashes across the Dow Jones ticker tape, which we have in our office, that disseminates information on various corporations.

Q What's the definition of "inside information" as used in the securities business?

THE COURT: Why are we getting into that? Why introduce into the case a completely extraneous topic that could confuse the jury. We have enough insider cases as it is without bringing it into a case where it doesn't have any connection.

MR. GOLDSTEIN: I will withdraw the question.

Q Take Allegheny, in the spring of 1974; what was the nature of the debenture that you had put Mrs. Grupe in?

A Allegheny was a debenture paying 6-1/4 percent --

MR. BLUM: I don't understand what the witness is being asked. Is it what he told Mrs. Grupe or is he being now asked to describe --

THE COURT: I take it the question is interest rate, date of maturity --

Q Yes. Describe the debenture.

A Allegheny had a debenture which paid 6-1/4 percent. It's called an "88." That means it's due -- the final date would be '88. The 6-1/4 percent would be on $1,000. If you purchased the Allegheny debenture at a thousand dollars when it came out for the first time in 1968, you would be getting 6-1/4 percent on your money.

If you purchased an Allegheny debenture at the time Mrs. Grupe purchased it at $590, for your $590 you would be getting a piece of paper that, in effect, said "Allegheny Corporation owes you $1,000, and we will pay you 6-1/2 percent on a thousand dollars."

And that debenture, very interestingly, had been half taken in, because the original issue was $20,000,000 and by the time Mrs. Grupe bought her debentures, they were down to only 10,000,000, because many people had converted into stock, and partially, the company had purchased some of their debentures, so that the debentures that were actually coming completely due, would be finally due in 1985.

Allegheny would be due in 1985, when they would have to pay $1,000 per debenture on any that were left.

Q Now, let's back up a little.

You said 1985 instead of 1988. Why?

A Oh, oh. When the debenture was first issued in 1968, it was a 20-year debenture due in 1988. But between 1968 and 1971-72, because of conversation, the people who had the debentures and found they could make more money by switching to the stock, and because the company bought in some debentures, there were only $10,000,000 left -- slightly over 10,000,000.

Now, the sinking fund provides -- the sinking fund is like the amortization on your mortgage -- you must pay in so much. When a debenture is brought out, they don't wait for the 20 years to pay off the money; they begin paying off the money after the first two or three years or, in some cases, after five years.

Q Mr. Lamula, let me interrupt there so that everybody understands.

Are they required to purchase a certain amount of face bonds each and every year?

A At a certain time. But they do have the right to purchase it even before they are required to do it.

Now, what happened in this instance, they purchased debentures before they were required to do it, so they took care of a number of years after that. As a consequence, the next purchase that they are compelled to make is $1,000,000 in '79, and $1,000,000 in '80, and $1,000,000 in '81, and $1,000,000 in '82; these 4,000,000. In '83, they have to purchase 2,000,000; that's 6. In '84 they have to purchase 2,000,000; that's 8. In '85, they have to purchase 2,000,000; and that practically ends the issue. There will be 2- or 300,000 left over.

So, in effect, what I had said to Mrs. Grupe and to other clients who purchase these,"While this is a 1988 debenture, it will not last until 1988; bearing in mind that as you go along, there are less and less debentures and the company cannot buy them in the open market. They may have to call your debentures in, so even though we are talking about 1985, it would be possible your particular debentures would be called in before, since they have to buy them."

Obviously, if they can buy them in the market for less than a thousand dollars, and the unit of trading in debentures is a thousand dollars, the company will buy them in the market. But if we were all debenture holders, and we decided we are not going to sell any to the company, then they would be compelled to draw numbers out of a hat and buy the amount they are required to buy at a thousand dollars a piece.

Q In other words, at face value?

A Right.

Q Now, as Mr. Rowney pointed out, this is considered a thin issue, Allegheny?

A Yes. He considers it a thin issue, but basically, what really happens is, there are $10,000 outstanding, but the people that have these debentures have been receiving interest since '68 --

MR. BLUM: May I request the witness be instructed to answer the question, and perhaps the rest can be saved for other questions or summation.

The question was: Did Mr. Rowney consider this a thin issue?

THE COURT: Yes. Just confine your answer to the questions asked, because it may be that some of your answers are going to objectable questions.

A I think Mr. Rowney did. I do not.

Q You do not consider it a thin issue. What's your definition of a thin issue?

A Basically, a thin issue is an issue where there is a very difficult market to make and a good company could become a thin issue if everybody that holds it decides they don't want to sell. It's conceivable that in many of these cases, the reason the term "thin issue" comes about, because people do not want to sell the bond for the price that is offered.

Q So, in other words, if Allegheny, after you put Mrs. Grupe into it, became a thin issue, it would be beneficial to her, would it not?

A It would be from '79 on.

Q Because then the company --

A They must buy a million dollars in '79 and '80 and '81.

Q A million dollars is a thousand bonds?

A They must buy a thousand bonds, a million dollars worth of bonds, in each of these four years as I have related, and then $2,000,000 worth each year.

Q Before you recommended Allegheny to Mrs. Grupe, had Allegheny missed an interest-payment period?

A No. As a matter of fact, Allegheny has a preferred stock on which they pay a dividend and that they are not compelled to pay.

Q What business is Allegheny in?

A Allegheny is in the distribution -- they have franchises in a number of soft drinks, eight or ten, and they distribute in Maryland, Virginia, Washington, and Pennsylvania; and they also place distributing machines in various localities, and their volume runs somewheres between 80- to $90,000,000 a year.

Q And was it doing that volume in 1974?

A They were doing a little bit less. They may have been doing it -- I can give it to you exactly, rather than guess. In 1974, they did 77,600,000.

Q Mr. Lamula, let me go back a little.

How did you find out about the 1985 due date instead of 1988?

A I had studied their report thoroughly. I had studied a K10. A K10 is a form, a voluminous form, which all companies must file with the SEC, that does give much more information than the annual report.

The thing that struck me about Allegheny is, in studying their debt -- and this is something I pointed out and marked up for Mrs. Grupe in the book I gave her -- the next contribution to the sinking fund was in '79.

Now, I do know from this report, and I did know, that they had outstanding, slightly over 10,000,000. When I began to calculate '79, '80, '81, and '82, at a million dollars a piece, four years, and then I calculated '83, '84, '85, I reached $10,000,000, and this was extremely puzzling to me. I decided I had to go to Baltimore and I called Mr. Lapidus and asked for an appointment. When I got in to see him, we chatted for a while; and then I said, "I would like to ask you a question that may seem a little bit foolish to you, but from my analysis of your sinking fund and the amount of debentures that are outstanding, even though the debenture expires in '88, as I see it you will have been compelled to purchase all of the debentures by '85 or shortly thereafter."

And he laughed. And I wondered whether I was wrong. And he called in his treasurer, and he said, "Meet the first guy who has been down here from Wall Street, out of the hundreds in the last five years, who has finally put his finger on the fact that our debentures will not go beyond '85."

Q I see.

Did you consider, in 1974, that Allegheny was a suitable investment for Mrs. Grupe?

A I did, because they were making money and they were paying a dividend on their stock.

MR. BLUM: Objection. I think the testimony should be limited to the questions.

THE COURT: Yes, but maybe we can save a little of this time if you asked the question: Did you? And if so, why.

MR. GOLDSTEIN: Yes.

Q What was your reason for your answer?

A Number one, this was 1974. This debenture had been out since 1968. They had been paying the interest on the debenture all these years, six years; and in addition to that, the debenture issue had been reduced from 20,000,000 to 10,000,000. One of the important things is to recognize how much they owe. If it's an issue with $100,000,000 in debentures, that's something one has to consider more carefully. But they were making money. They made money in '73; they made money in '74; and in each year for the last six or seven years, they have been paying a stock dividend on their stock.

Now, this is of help to the debenture holder for this reason: That if you have a $1,000 debenture in Allegheny Beverage, no matter how much you paid for it, whether you paid 600 or 700, you are getting the interest of 6-1/4, which might be 11 percent on your money, as it was in Mrs. Grupe's case, it was 11 percent on her investment--

but they also say -- and this comes in the first instance, "If you will lend me a thousand dollars for 6-1/4 percent, I recognize that this is a not high enough interest, but in order to make it advantageous to you, we will allow you at any time during the 20 years, to change this debenture into stock at this price -- at a fixed price, no matter what the price may be five or ten years or fifteen years from now."

This, in Wall Street parlance, is termed "a sweetener." It's done because, if Allegheny sold a bond, they could have sold a bond, but they might have had to pay 8 or 9 percent. So in order to induce you as a buyer to buy it at 6-1/4 percent, they said "We will throw in this sweetener so that you can convert. If our stock goes all the way up, you will get the benefit of it," so much so that thousand dollar debentures have sold far higher than a thousand dollars in many cases. We have had one debenture that sold as high as $5,000. A piece of paper that said "I.O.U. $1,000" was actually sold for $5,000. Why was that? Because that piece of paper was convertible into the stock at $12. The name of the company is Maculo Oil. The stock went up to 60.

MR. BLUM: Your Honor, again --

THE COURT: We are going a bit far afield.

A In this case -- in Allegheny.

MR. BLUM: The question has been answered. Let's go on to the next one.

THE COURT: Put a new question.

Q What were the attractive features for D.W.G. in May 1974 for somebody in Mrs. Grupe's category?

A D.W.G. is a company that owns a gas company in Florida. They operate in some 15 states. They own a servicing company and a shirt company, but the bulk of their company comes from two utilities, in effect.

They had a 5-1/2 percent debenture. It was selling in the middle 50's. The 5-1/2 percent on a thousand. If that were purchased at $550, one would be getting 10 percent on one's investment.

In addition to that, the stockholders -- rather the officers and the directors, were very heavy owners of stock, as in Allegheny, all the directors, of stock in the company and debentures. In D.W.G., Victor Posner, the president, is a very substantial stockholder, has several thousand shares of stock, and so do other members of the board.

My rationale at the time was: Their income is going up; they are in a safe business; the debenture is selling for the middle 50's, which would bring a return of

10 percent. You would buy a thousand dollar debenture for $550 -- and this is exactly as I explained it to Mrs. Grupe -- the return would be 10 percent; and in addition to that the company was going to begin paying a dividend on its stock, but they were going to pay a stock dividend. And when the company pays a stock dividend on its stock, it changes the price of your conversion.

If they say "This bond, this debenture, is being sold to you and you can convert it into stock at $15," every time they pay a dividend in stock, that issues more paper. Therefore, they have to reduce the price, so much so that when we purchased these debentures of D.W.G., the conversion price was somewheres in the area of $12, and it's now in the area of $8.50. This is because of the stock dividends that they have paid.

So I found this a very acceptable company with good management and an issue that wasn't too large and paying stock on their -- paying a dividend on their stock.

Q What was the sales volume in 1974?

A I beg pardon?

Q Sales volume in 1974?

A I will give it to you exactly. It was considerably in excess of a hundred million, but let me give it to you exactly. The volume in 1974 was about $110,000,000.

Q By the way, going back to Allegheny for a minute, what was the current asset to current liability ratio in 1974?

A 15.9 against 15.8.

Q What about for D.W.G.?

A Bob, may I borrow your copy of D.W.G.

MR. BLUM: That is a 1973, not a 1974, report.

Q I will tell you what, Mr. Lamula. To save time, let's go on. We will leave that question in abeyance for a while.

Next was Applied Data. Why did you consider Applied Data a suitable investment for Mrs. Grupe in May 1973?

A Applied Data is a very interesting company that only had about $1,800,000 left in their debenture issue, and the provision in the agreement for the sinking fund provided that they had to buy in $168,000 each year. The market was becoming very thin, when it had gotten down to 1,800,000 or 1,700,000. One of my reasons I had talked to the president and the treasurer of that company and had asked them whether they would consider -- I had gone to see them in Princeton, New Jersey, when they needed money -- when they needed debentures for the sinking fund -- to come to me; that we had clients who had them. My basic reason for buying it, over and above the fact that I liked the company and that they were doing well, I realized there were not many debentures available in trying to buy them in the market, and if one made an attempt, if there was an offer, you could probably buy five, which is the unit of trading; and then the dealer could raise his price by five or ten points, because it was a thin issue in that regard.

But people that had these debentures were not ready to sell them. So my purpose for getting in there was, that I had hoped to sell them to the company at a much higher price, and I did sell them one block recently, about a year ago, of 144,000 at $750 a piece, and they have recently offered $800 per debenture; but some of the people that we have in it prefer not to sell them and I understand it and I agree with them, because this comes due in 1983.

MR. BLUM: Once again, your Honor, aren't we traveling rather far afield?

THE COURT: Please proceed.

Q What was their sales volume in 1974?

A I know it, but let me give it to you from the record.

Q If you can give us your best recollection instead of looking it up, unless you have it right there.

A About $30,000,000.

Q Can you give us your reasons for advising Mrs. Grupe to purchase Arwood debentures in May 1973? I am sorry, in 1974.

A Arwood is a very interesting company that was doing about 35- to 40,000,000, and there again they were making a profit and their debentures had been reduced to about 1,600,000, and they were seeking to buy them in. There had been stories around Wall Street, and I mean on the ticker tape, where some companies had been making an approach to buy Arwood, and, therefore, the Arwood Corporation itself was seeking to buy in some of their own debentures. And I was interested in purchasing these debentures and placing them with clients, and we do have about 30 to 40 clients that still have Arwood, for two reasons:

One, because I thought the company was doing well.

And two, because I thought, in a merger, this would enhance the strength of the bonds.

And the third reason was, that since the issue was so thin, 1.6 left, that they might want to wipe it out completely in a merger. As a matter of fact, they have since merged with Interlake Corporation, although we did sell them some bonds about six months ago at a price, I believe it was 70 -- at a price of 70 or 75, but I have the records with me of the debentures we sold them at that price, which they wanted to use for their sinking fund. But now, they are part of the Interlake Corporation and, of course, the people that have those bonds will be paid 100 cents on the dollar as they have to buy them for the sinking fund.

Q Is Interlake a substantial company?

A Yes, Interlake is one of the giants. It does almost $800,000,000 to $900,000,000 a year. And Interlake bought them and paid, in effect, approximately $14 a share.

MR. BLUM: May we know when that happened?

THE COURT: Yes.

A Within the last four or five months.

MR. BLUM: Thank you.

Q Now, with reference to Inflight, what's their business?

A Inflight shows motion pictures and has contracts with approximately 30 of the major airlines, and these are fixed contracts for three years at a time, and a fixed fee. They have contracts with United Airlines, American, TWA, Pan American, El Al, Alitalia, the Swissair lines;

all of the European airlines.

In addition, they make some movies for TV. And the third fact, they now make movies, and they started a couple of years ago, that may be seen in a hotel room for a fee that could be charged to your room.

Q What was your reason for advising Mrs. Grupe to purchase that in May 1974?

A I liked the management of Inflight. I found that they were taking very heavy sums for depreciation out of the gross money they took in. While they paid all their expenses, they didn't seem to show too much of a profit, but they took about $2,500,000 for depreciation, which is money they put on the side, but which stayed in their treasury. The fact that the sinking fund had begun, the original issue was 6,000,000 and they had to retire $300,000 a year. And the further fact that in 1973, they sold 1,800,000 shares of additional stock to the public, and that meant that there was more money behind the company and more money, naturally, behind the debentures. And this 1,800,000 shares of stock was sold at 350 a share, if my memory serves me correct, and I will have a prospectus. And the underwriters of that--there were many well-known Wall Street firms, but the principal underwriter was Burnham & Company, the company of the expert that you heard the other day.

Q Mr. Rowney's company?

A Yes.

Q What was their sales volume in 1974?

A About 20,000,000.

Q What were your reasons for putting Mrs. Grupe in Knight Industries in 1974?

A Knight Industries is a very interesting company. The name "Knight" comes from the principal stockholder. The principal stockholder has 173,000 shares of stock. He needed some extra money for expansion and in 1970 a company by the name of Advest, which is a well-known brokerage firm, sold $1,200,000 worth of debentures.

While I liked the company, I decided to watch it for a year, a year-and-a-half, and when the debentures -- the debentures were to yield 7-3/8ths percent on a thousand dollars --but when the debentures fell to approximately between 80 and 75, I decided to begin to buy them and to begin to put people in where I could sell them and recommend them, because I had gotten to know the president. I knew they were making these gas turbines and equipment for the oil industry, and while it was a small firm, the stockholders, the officers, had a large interest in the stock. But the whole issue was 1,200,000 and the sinking fund was to begin in '72, and they had to buy in $60,000 a year, so that as of now, while the volume of the company is only 10,000,000, they show a very substantial profit on their volume and their debentures have been reduced to $900,000; and commencing in 1978, they have to buy $60,000 this year and next year; and then commencing in 1978, they have to buy 120,000, and in this case you can't buy these debentures; there is only one house in recent -- over the last six months or a year, that has been bidding on them, and that is Advest and Company, and I know that they are bidding on them for the sinking fund. I could sell some to the company for their sinking fund, but since the debenture comes due in 1983 I see no wisdom in selling the debenture for 80 or 75 to the sinking fund when the people who have the debentures will get a thousand dollars by 1983 and perhaps sooner.

Q Mr. Lamula, you mentioned one thing which I want to expand on. How does a firm become a market maker?

A Every firm is actually a market maker. Some firms are actually market makers even on issues that are listed on the New York Stock Exchange. They decide not to go through the Exchange. But basically, what a firm does, when we decided to become market makers in a stock called "Tampax--or maybe I should stick to these issues --

in Technical Operations, it meant that we submitted our names to the Special Quotations Bureau and for a fee our name is listed after they have checked our references and our background and we are able to trade in a number of issues.

This means that we decided we were ready to buy and sell. A market maker is one who is ready to buy and sell for his own account. If we are listed as a market maker, then it means that people can come to us. Merrill Lynch who may not be a market maker in that issue, and they are not -- if they want to buy or sell that issue; we don't know whether they do want to buy or sell -- they ask for a quote, and predicated on our quote, they may offer to buy or sell.

Q Okay. Now, do you need the permission of the company before you become a market maker in their issues?

A No, not necessarily, but the companies prefer -- one of the reasons that many companies -- American Express is not traded on the New York Stock Exchange. Tampax, which is a very large company, is not traded on the New York Stock Exchange. Westmoreland Coal is not. These are joint companies. The reason for it is, that if they are traded on the stock exchange, there is only one market maker: the specialist on the floor of the exchange. But in American Express or Tampax, there are 15 market makers, Merrill Lynch, Bache, and all of the leading companies are fighting each other, and this is one of the reasons that many companies that are giants, prefer not to be listed on the stock exchange.

Q What were your reasons in May 1974 for recommending Lincoln Mortgage to Mrs. Grupe?

A Lincoln Mortgage was in the mortgage investment business, but had fallen down with all other companies in that field, except that I felt we knew them from the very beginning. This is one in which we are in the underwriting and some of the people we had in it sold it and made a profit. But when it got down to below 50, I had gone to California and saw some of the officials -- I had occasion to be there -- and I found they were beginning to shift from mortgages to foreclosing and taking in the properties, and they were in a position where they were owners of properties rather than just having mortgages.

So it had been my conclusion, after asking many questions, that they were in a much better position than some of the others -- Chase Mortgage Investors, which is a stock that had been sponsored by the Chase organization and sold the stock now, sold in the 70's, is now selling at $3 a share. But this is because they were -- all of these companies got hurt in lending money out on mortgages and builders were not able to pay these mortgages off at the high rates. But in the case of Lincoln Mortgage, while they have some mortgages, they also have equity investments in properties and they have been able to continue to pay their interest.

MR. BLUM: May we have a time frame. We are getting "have" and "had."

THE COURT: I understood him to say they had these ownership properties at the time he recommended them.

MR. BLUM: I understood most recently he is saying "have," and "had." I am interested in knowing the answer to the question: why he recommended these in the spring of 1974.

THE COURT: Did all the factors you just mentioned pertain in May of 1974?

THE WITNESS: Yes, they did, your Honor.

Q What were your reasons for recommending Nortek in May 1974 to Mrs. Grupe?

A Nortek is a very interesting company. Their volume runs about 50,000,000, a little more. They are in several different fields: One, in the quarry business; two, in the electronics; three, wire and cable production. And prior to recommending the stock, they had purchased two or three companies with cash.

And in addition to that, I found that they had two debentures. I went to see one of the officials, the president, a man by the name of Papito, and I found in the area of these two debentures--I would like to give you the figures accurately -- they had a 7 percent debenture and a 6. We are dealing with a 6 here, but in order to give you the picture, I will have to tell you about the 7. The 7 percent debenture was originally issued -- the 6 percent debenture was issued, first, in '88. The original issue was 6,500,000. That 6,500,000, by purchase made by the company, was reduced to 3,190,000. The 7 percent issue, which was issued a year later, was issued in the amount of 4,600,000, and that has been reduced to 894,000.

MR. BLUM: As of what time was this reduction?

THE COURT: When?

THE WITNESS: As of the end of 1973, before I discussed these with Mrs. Grupe.

A So that my rationale was that here is a company between 6.5 and 4.6. They had over $11,000,000, and this 11,000,000 had been reduced to 4,000,000.

In addition to that, the Nortek people came to me -- we were already trading in the debentures because of what I saw and liked--and asked me whether we could buy some bonds for them for their sinking fund, and offered a price of 55 to 60. I said, "I don't think so now, but try us again next year," or "We will keep in touch with you."

So the fact that Nortek had reduced their debentures from 11,000,000 to 4,000,000; the fact that they had been paying the interest all this time; the fact their officers are stockholders, and they are paying a small dividend on their stock and they purchased a company for 5,000,000, and they purchased another one for 4,000,000 with cash and notes, I felt this was a growing company. It had good management, and it was safe to buy these debentures. The interest was being paid. And on the basis of the prices that we were paying for these debentures, the purchaser would be getting 10 to 11 percent, depending upon the price paid. If somebody bought them at 60, it would be 10 percent. If he bought them at 55, it would be 11 percent. And in some cases, some people bought them at 50 and are receiving 12 percent on their income.

Now, over and above that, you have the potential profit of getting $1,000 for each debenture that you bought for $500, or whatever the figure might be.

Q In every one of these debentures, had any of those companies defaulted in any interest payment prior to May 1974?

A No, and not since; and more importantly, all of the officers are stockholders and they come after the debentures. In many cases, some of the officers have debentures.

MR. BLUM: Again, your Honor, I think there ought to be answers to questions, rather than lectures from the witness.

THE COURT: It would be better.

Put your next question.

Q In each one of these cases, you had done exhaustive research prior to recommending anybody --

MR. BLUM: Objection to the form of the question and also as leading.

MR. GOLDSTEIN: All right, withdraw the question.

Q Prior to recommending anybody -- strike that.

Prior to recommending any of these issues to anybody, what did you do with regard to getting acquainted with the company?

A Before we start to trade in any one of these issues, or any other issue--and we have traded in other issues besides these, but we never trade in more than 10 to 15 at any one given time; some drop out and we pick up some others or I study some others -- I study their annual report. After studying the annual report, I study the K10 that is sent to the SEC, which has to give a lot more information. I then check out who the underwriters were when the issue first came out. And I try to contact somebody in a Wall Street firm -- and most people know other people in Wall Street firms -- to get their picture and their understanding of the background. I talk to some of the other dealers in these issues.

Then, if the thing looks good to me, I think it is worth-while, I call the company and ask them some questions, questions which anybody can ask, and information that would be available to anybody who has the questions to ask. And in some instances we might not trade these issues if I am not completely satisfied, and in others we decide to trade them.

Q Wouldn't it have been enough just to check on these companies in some library?

A I'm not satisfied at all with the information given at a library or by Standard & Poor's or Moody's. I like to think that these are special situations on which I have spent a lot of time, on which I have gotten to know the offerings of the company, and that I know more, or I believe I might know more than somebody else, but that's because I concentrate on only a limited number of companies. I don't believe anybody can be an expert on more than 20 or 30 companies at the most.

Q Now, when you say you did all these things, spoke to the company, et cetera, you mean you personally, not just John Lamula Investors?

A No, I did personally.

Q What was your reason for advising Mrs. Grupe to purchase Technical Operation in May of 1974?

A Technical Operation was a growing company and it had a very interesting background. They were in electronics and they were doing about 20- or $25,000,000 a year. I watched the debentures --they came out in 1970 -- and began to just look at it and ask for their reports. In 1971, a company by the name of Vappi, which was in the construction field in Boston and out West, doing about $50,000,000, was privately held, and the company was about 50 years old, but privately held, and they decided to merge with Technical Operation. So they took their $50,000,000 of business and the 50 years of experience and put it in with Technical Operation, and Mr. Vappi and the members of his family took back stock in Technical Operation, some 600,000 shares, which made him a stockholder owning about one-third of the company in stock.

At that point, my thought was that I would discuss with Mr. Vappi why he did this, and he said,"Going to Wall Street and going public cost too much. By merging with Technical Operation, since Technical Operation is a public company, we in effect become a public company; and, therefore, I think we have great prospects in this company and I'm willing to put my $50,000,000 of volume and the profit and all of the assets of Vappi and Company into Technical Operation."

I decided at that time in my own mind, after having gotten that answer and the answer to my many other questions, that now Technical Operation was a company doing 70,000,000, and when Mrs. Grupe bought it, they were doing about 80- or 85,000,000 and making a profit; and Mr. Vappi, who was chairman of the board, came after the debenture holders, and since there were only $4,000,000 in debentures outstanding and they were due in 1985, and the sinking fund started last February, February of 1976, they bought in $320,000, I decided in my mind that I could see no risk in a company doing 80- to $90,000,000, making money, and having a $4,000,000 issue on which they would have to start buying in in 1976. They have already purchased the first 8 percent, $320,000, and they are obligated to buy 8 percent more by February 1st.

Q Now, Mr. Lamula, you stated that Mr. Vappi, as a shareholder, came after the debentures. What do you mean by that?

A I mean that Mr. Vappi, who owns stock in the company, must wait for any monies that he might receive, except for his salary, until after the debenture holders are paid off. In effect, the debenture holder is a creditor. Technical Operation has a debt that must be paid by 1985. It must be paid annually beginning with 1976. So that must come before the stock. And while Mr. Vappi is a large stockholder, and so are some of the others, the debenture holders have to come first.

For example, in Technical Operation, Mr. Vappi has 366,000 shares and owns $50,000 worth of debentures, the same debentures that Mrs. Grupe bought, but he owns them at a thousand dollars per debenture, because he bought them when they came out.

Q Okay, Mr. Lamula --

A Mr. Shaw, who was the president --

Q Mr. Lamula, I know we can go into it deeper, but time dictates we have to go on.

In what business is Technical Operation?

MR. BLUM: At the time.

Q At the time, 1974.

A By 1974, besides their electronics and equipment for servicing planes, they were also in construction and in the radio business. They had purchased several radio stations.

Q Did you mention the radio stations to Mrs. Grupe?

A Yes. Not only did I mention it, but she knew the station in Buffalo very well. She said she listened to that station.

Q And now, what was your reason for recommending Monroe in May 1974?

A Monroe had for many years been in the textile business. They came out with an issue of 2,700,000 in 1969, I believe, and their stock did so well that that debenture went up above a thousand dollars. Why did the debenture go above a thousand dollars? Because the debenture was paying 7-7/8's percent. But they said in effect to the purchasers, "If you buy this debenture for 7-7/8's percent, it would cost us more if we tried to sell a bond. We will make it attractive to you by allowing you to convert into stock at $10 a share."

So that for each debenture, you could get a hundred shares.

Now, when the stock got up above $10 a share, the debenture had to sell for more than a thousand dollars. For example, when the stock got to $11 a share and you could get 100 shares for your debenture, your debenture had to be worth $1100. And when the stock got to $12 a share, your debenture had to be worth $1200. And when the stock got to $13 a share, your debenture had to be worth 1300. And I sold many debentures for people who bought them earlier at prices of 1100, 1200, 1300.

When the stock went down to somewheres in the area of 7 and 6, we began to repurchase some of these debentures, because by that time, the company had begun its sinking fund and the $2,750,000 of debentures issued in the first instance, as the result of the conversion I have related to you, had been reduced to 1,600,000; and my opinion at the time was, if this debenture is available for $600 a share, 650, it pays 7-7/8's percent, that would be equivalent to about 11, 11-1/2 percent -- I have had people who purchased these debentures and sold them at a substantial profit--that it would be worth going into them, and that was my reason.

Q What was your reason for recommending Elco?

A Elco is a very interesting and a very fine company. It's a small company in electronics, that does about 30- to $35,000,000, but the company was a very profitable company.

MR. BLUM: Again, your Honor, may we have this confined to the time we are talking about.

THE WITNESS: In '74. I am talking in the framework of 1974.

A In reviewing this with Mrs. Grupe, I pointed out that just at about that time this company had 4 --

MR. BLUM: I don't think it's been established this one was reviewed with Miss Grupe. This was bought in July.

THE COURT: That is a point.

Did you ever discuss Elco with Mrs. Grupe? This is one you didn't purchase in May.

THE WITNESS: Yes, as a matter of fact, I did discuss it with Mrs. Grupe. I discussed all of them; but I also discussed Elco, which was purchased later, and I am relating now my discussion.

THE COURT: Go ahead.

A In the question of Elco, there had been shortly before--while we are dealing, buying and selling Elco for the last few years, one of the reasons that I was attracted to Elco was that the debentures were only $4,500,000.

Now, this is a very intriguing company. They owed $4,500,000. Their volume was only 35,000,000, which may sound nominal.

Bob, may I borrow your copy of Elco?

MR. BLUM: I don't think I have an annual report of Elco. As far as I am aware, my client never received one.

A Very well. I am now reading from the annual report of 1972. The report I gave Mrs. Grupe was '73. But the report in '73 is better than the report in '72. But this is what I would like to point out. That on their balance sheet, their assets for '72 -- this is two years before, but the report that I used with Mrs. Grupe, was naturally, the '73, not the '74, because the '74 wasn't available -- but the '73 was better than the '72. They were making a profit Their volume ran about 25,000,000 in '73, and about 35,000,000 in '74. But the very intriguing thing that caught my attention in studying this was, that their total current assets, not all assets, with their machinery and everything else, but just current, the assets that could be reduced to cash, amounted to $13,600,000. Their total current liabilities were only 2,500,000. As a matter of fact, in their assets, they had a million-and-a half in cash and they had $2,500,000 in commercial paper just to earn some interest on that money.

Q Mr. Lamula, excuse me. That would mean that they had about a 6:1 ratio?

A Their ratio was about 6:1. It's probably the highest ratio --

MR. BLUM: If I may, your Honor, it does grow a little tiresome, having counsel put words in his client's mouth. I don't think his client lacks for them.

THE COURT: That was a mathematical differential. I don't see anything wrong with that.

Q Mr. Lamula, you were here the other day, when Mr. Rowney commented 3:1 was a very good ratio, were you not?

A I believe he said 2:1 was a good ratio.

Q What has happened to Elco since May of 1974?

A Elco has been -- at the time in '74 when I discussed this with Mrs. Grupe, I told her that there were current stories around that appeared on the tape. There were several companies that were trying to buy Elco. One company offered $7 a share, and in order to make this more explicit, there were about 1,600,000 or 1,700,000 shares. Then another company came along and offered $8 a share. But the management of Elco was resisting this. They realized they had a lot of cash and a lot of money. They could have taken all their assets and paid off all their liabilities, including the debentures, and still have a lot of money left over.

THE COURT: Let's not get into the reasoning of Elco management. Just tell us what became of Elco. Were they, in fact, acquired?

THE WITNESS: They were, in fact, as the result, acquired by Gulf & Western for approximately $15,000,000.

THE COURT: When?

THE WITNESS: About a year ago.

Q Now, Mr. Rowney stated that after the acquisition, Gulf & Western advised Elco debenture holders that they could only look to the assets of Elco for repayment. Wasn't that the situation that existed prior to Gulf & Western purchasing Elco?

A I am sorry, I don't get the question.

Q Wasn't that the situation prior to Gulf & Western acquiring Elco?

A Of course. That is the usual procedure.

Q Did Elco retain assets after being purchased by Gulf & Western?

A Yes. Not only did they retain the assets, but the sinking fund provision provides they must begin to buy $500,000 a year in 1978, which seems far off, but we have sold some of these bonds to Lehman Brothers, who has been requesting us to seek bonds for them.

MR. BLUM: I think we have gone far enough afield on this one, too.

THE COURT: Yes. It's after 5 o'clock. We will suspend for today.

It appears, ladies and gentlemen, we will be able to finish this case within a couple of days. Consequently, it will not be necessary for you to come in tomorrow. You can go exercise your other civic duty tomorrow and go out and vote.

We will reassemble here Wednesday morning at 10 o'clock.

I again caution you not to discuss the case with anyone.

(An adjournment was taken to November 3, 1976, at 10 a.m.)

tpas

BERNICE C. GRUPE

- against - 75 Civ. 2083

JOHN LAMULA INVESTORS, INC.,
and JOHN J. LAMULA

New York, New York
November 3, 1976 - 10:00 a.m.

- - -

(Trial resumed)

THE COURT: Good morning. I understand there is an application.

MR. BLUM: Yes, there is, your Honor.

First of all, due to time commitments, we were unable to meet yesterday. I gathered, the usual holiday secretarial problems which made it difficult for him to assemble questions. Each of us has a set of proposed special interrogatories to submit to you.

THE COURT: Have you looked at each others?

MR. BLUM: I have, but I don't think there is anything in here I can buy. I don't know if he's looked at mine.

MR. GOLDSTEIN: I've glanced at them. There is no problem with them.

MR. BLUM: You want to review them at lunchtime?

THE COURT: See what agreement you can reach.

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If I make it an all-or-nothing choice, I will accept neither and I'll draft my own, which neither of you will like, and the Court of Appeals will like less.

MR. BLUM: I firmly assume the Court of Appeals will have nothing to do with this.

MR. GOLDSTEIN: There is one other point. I assume we're going on a special interrogatory, with the jury to render a general verdict?

THE COURT: No.

MR. BLUM: 49-A, I assume, is what you are under.

THE COURT: I don't have the rules in front of me.

(Handing)

MR. BLUM: I assume what you meant to do was separate liabilities and damages.

THE COURT: Yes, 49-A, special verdict. There are several theories of which the jury can render a verdict. Consequently, the general verdict doesn't exist. It would promote the inconsistent verdict. They could make special interrogatory findings that did not conform with the general verdict findings, if the general verdict constituted a statement of damages.

MR. GOLDSTEIN: I believe 49-B takes that into

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consideration in cases where the answers they give and the verdict are inconsistent. I will respecfully move that the jury be given the opportunity to make a general verdict rather than a special verdict.

THE COURT: I'll consider that.

It depends in part, on how we can word the special interrogatories.

MR. BLUM: Again, it seems to me in reviewing it, 49-A makes the most sense, that way we can separate it out.

I think there are six separate theories of liability here with regard to the two basic areas: the way which they were sold and the markup.

THE COURT: I'm interested in what damages can be discerned. There are more than one theory on what one set of damages are. It seems there are three damage possibilities. The two things to avoid are the jury making a finding under one theory of liability, and returning damages that only apply to another theory that they haven't found; and the second thing to avoid is them accumulating damage recovery where they wouldn't accumulate.

MR. BLUM: Exactly. If they found liability on both counts, both areas in fraud -- for example, were

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only entitled to actual damages of that 32,000 number.

THE COURT: If they find a liability and security fraud on a markup basis, the markup damages, it seems to me, would be included in the current loss that they can't recover both.

MR. BLUM: We concede that. It also separates out punitive damages, which doesn't get considered, unless they make specific findings with regard to common law breach of fiduciary **duty** or common law fraud, that's why it seems 49-A was a more **appropriate approach from the way** we looked at it.

THE COURT: When you speak of a general verdict, Mr. Goldstein, what did you have in mind? Having answered certain questions in the affirmative or the negative, they then would conclude by saying we find for plaintiff or defendant, and if they find for the plaintiff, giving an amount of money?

MR. GOLDSTEIN: Not necessarily. The money damages might be separate and apart, but just finding guilt of common law fraud, as your Honor will direct, or statutory fraud, etc. I believe the section is very clear, if there is some inconsistency the Court has the power to enter a judgment **appropriately** or in more drastic cases, order a new trial.

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THE COURT: I'm aware of that. That's what I'm trying to avoid. It wouldn't make sense if they answered all questions **negatively, and threw** in a general verdict for the plaintiff.

MR. BLUM: That's why it seems 49-A was the easiest way to deal with it.

THE COURT: Conversely, if they answered some of the questions affirmatively, it wouldn't make sense to return a general verdict for the defendant.

MR. GOLDSTEIN: In some cases it may, because of the various elements that have to be proven.

MR. BLUM: Candidly, I think you're better off under 49-A. Maybe we can talk about that at lunchtime, too.

MR. GOLDSTEIN: OK.

THE COURT: It depends in part, on what you can do with your interrogatories. If they create great problems, you may have to rethink the whole matter. Let's bring the jury in.

MR. BLUM: I have one other application.

With regard to the question of the NASD rules, I have a short memorandum, which I dictated this morning, and should come down. It seems clear under Rule 201 of the Federal Rules of Evidence, judicial notice may be taken at any time, in the Court's discretion, any time in

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the hearing, in the Court's discretion, and must be taken if the request is made; and I now do wish to make it that they be considered, that this qualifies as an adjudicative fact under 201-B as being "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."

THE COURT: Do you have any cases applying 201 to NASD rules or similar bodies of rules?

MR. BLUM: No. As far as we were able to discover, there has been no application of this. The evidence, and I think you cited it, pretty clearly indicates the scope and the far more restrictive rule, 4511 of the New York CPLR.

The Third Circuit, long before 201 was adopted back in 1946 or '47, took judicial notice of the burial rules of the Roman Catholic church in a dispute, although far less than commonly accepted. We do find one case which bears on it, but I think it's quite distinguishable 201 is virtually limited to its facts.

In 1931, before any security acts, the Court of Appeals for the Second Circuit considered a case called Salmon Weed & Co., in which there was a question raised in the Court of Appeals respecting a rule of a New York Stock Exchange. The Court of Appeals declined to take notice of it, but said it didn't apply to the facts of the case.

I think the development of a law, particularly the establishment of 201, and the discussion of the history of the evolution of this distinction between adjudicative fact and legislative fact expressed in the beginning of 201, cited in the short memorandum, makes it clear that this is precisely the kind of subject matter which the drafters in Congress intended to be subject of judicial notice, and particularly if called to the Court's attention if at any time during the proceeding.

THE COURT: I'll read your memorandum of law. Do you wish to submit anything in opposition, Mr. Goldstein?

MR. GOLDSTEIN: Yes, your Honor. In addition, I would wish to point out that there has been no testimony, as far as I remember, from Mr. **Lamula,** as to the applicability of the NASD rules in this case, specifically what rules are applicable, and any interpretation thereof,

however it affects this case. I would think that would be paramount before we even get into the question.

THE COURT: Not really. What is more paramount, while you got into evidence the fact that the defendant has never been reprimanded by the NASD, you never bothered to get into evidence, either of you, the fact he's a licensed

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security dealer. Think on that.

MR. GOLDSTEIN: I believe that's stipulated.

MR. BLUM: That is correct.

THE COURT: In the pretrial order?

MR. BLUM: Yes, your Honor.

THE COURT: There has been no evidence here at trial.

MR. BLUM: It's at the outset of the pretrial order, which I think does provide a foundation for my request to the Court.

THE COURT: Yes. I suggest anything from the pretrial order in the stipulation that you want before the jury, you best read to the jury. There is no possible way they can know about it unless you tell them about it.

MR. BLUM: I'll go through my checklist again, your Honor.

THE COURT: Bring the jury in.

(Jury present)

THE COURT: Have the witness return to the stand.

JOHN J. LAMULA, resumed.

DIRECT EXAMINATION (Continuing)

BY MR. GOLDSTEIN:

Q Mr. Lamula, going back to the late winter and spring of 1974, did there come a time when Mrs. Grupe authorized you to make certain purchases on her behalf?

A After the third or fourth meeting, Mrs. Grupe asked me to make some purchases on her behalf. I said, "I'd like to wait a little bit longer, let's discuss it some more, and let me make sure that you have this picture complete. Let me go over these reports and proxy statements with you again. You still have time until your certificate of deposit comes due."

Q Did there come a time when Mrs. Grupe advised you when the certificate became due?

A Yes. I believe at some point during this third or fourth meeting, or second meeting, I found out that the certificate was to come due on July 15. Mrs. Grupe mentioned it to me.

Q Now, when you said she had time to make her purchases, what did you mean?

A I meant we had time until July 15.

Q It was your intention at that time not to make any purchases until July?

A My intention was to continue to discuss matters with her, talk to her about a broker in Buffalo. At the same time, to make sure she clearly understood these reports that I brought to her, the items I marked off. I sat alongside her and marked off the items, went over the proxy statements and showed the holdings of people in the company, pointed up --

MR. BLUM: Your Honor, I think this is cumulative and not responsive to the question.

THE COURT: Yes.

Q Mr. Lamula, who decided on purchases being made in May?

A Mrs. Grupe decided on the purchases being made in May because --

Q On what basis?

A -- because the legislature was due to adjourn about the middle of June or the third week in June, and she and Miss Emerson and a number of other people had plans to go to Europe on June the 24th and not return until early July. At that time, with the legislature out of session, having adjourned, she would be going back to Buffalo. She raised that question with me.

I said, "There is really no problem. You could come to New York and we'll go over it at that time."

She said, "Can't we do it before the legislature adjourns?"

I said, "If you want to do it before the legislature adjourns, call the bank. You know the vice president, he's a friend of yours, you call him by his first name, and tell him that you would like to borrow a hundred thousand dollars against the certificate of deposit."

Q Do you know if that is what Mrs. Grupe did?

A She did.

Q How do you know this?

A She told me she did.

Q Did there come a time at the end of May, May 29, I believe, or May 28, when you accompanied Mrs. Group to the bank?

A This was after we had made the purchases and after we had sent her the confirmation, and the confirmations were mailed to Albany at her direction. She didn't want any mail to go to Buffalo or to the suburbs of Buffalo.

Q Did you accompany her, at your suggestion, to the bank?

A No.

Q What were the circumstances of your going with her to the bank?

A Mrs. Grupe had received a statement together with the purchase slips. We had a number of purchase slips, and then we had a covering statement, which she had received one or two days after the purchases were made, in Albany.

When I saw Mrs. Grupe on the following Tuesday, she said she had some reluctance about the bank, she was uneasy. I had asked her to call her friend and she did.

She made an appointment for the next day. She then asked me would I accompany her. I said, "You don't really need me. It's your money, he's a friend of yours. If he asks you what you're going to do with the money, I presume he will, tell him what you intend to do with the money, you intend to invest it. If you want me to go along with you because it will be more comfortable, I'll be glad to do it. And if he has any questions, I'll answer them."

This is why I went along. She said she felt embarrassed because she knew the man. I said, "You're not taking the money out of a bank and putting it in another bank; you're buying securities because they lowered the interest rate."

Q There is testimony you accompanied her to the bank the following day, is that true?

A Yes, I believe it was on a Wednesday.

Q What was the purpose of going to the bank that day?

A Mrs. Grupe wanted to go to the bank and she wanted me to accompany her. The purpose of going to the bank that day was to obtain a loan on the certificate of deposit; since the certificate of deposit wasn't due, any bank will give one a loan for that same amount and credit that money to your account and then use the certificate of deposit when it comes due to pay off the loan. They would keep the certificate of deposit as collateral.

Q That's the first day. The second day, did you also go to the bank with her?

A Yes.

Q What was the purpose of that visit?

A The purpose of that visit was -- by that time I believe it was May 29, May 30, and there was a branch of the bank right down the street. I said, "Bea, will you make out your own check and get it certified so that we can get credit for it at our bank, otherwise we wouldn't get credit for a check out of town for this amount for ten days."

She said, "Will you go with me?"

I said, "There is really no need for me to go with you, you have this money on deposit at the same bank. They will certify it. If it makes you feel any better, I'll walk down the street." It's about half a block away from the Capitol.

MR. BLUM: Objection, your Honor. We're

running far past the answer to the question.

THE COURT: Put your next question.

Q Did Mrs. Grupe ever state to you that you had made purchases without her knowledge?

A Absolutely not.

MR. BLUM: Objection, your Honor. This is a leading question.

THE COURT: It came up in her testimony.

A Absolutely not. I called her on the day we made the purchases. These are the items, jot them down, bills will be going out today or tomorrow.

THE COURT: I think he's directing himself particularly to the purchases made in June or July.

THE WITNESS: Yes, the batch of purchases, your Honor.

THE COURT: Not the initial purchases, but the later purchases?

THE WITNESS: Is the question to the later purchases?

Q The later purchases.

A The later purchases?

Q Yes.

A On the later purchases, we had sent Mrs. Grupe a typed statement showing each of the issues.

MR. BLUM: Your Honor, once again, the question is: Did she complain about those purchases? I respectfully request counsel be instructed to ask the question so the answer relates to something that I can deal with.

THE COURT: I think he asked the question properly, but we got off the track. Did you ever have a complaint from Mrs. Grupe about the purchase of the second set of Technical Operations?

THE WITNESS: Absolutely not. At that time, she was back in the Buffalo area and we had gotten instructions from that point on, when the original batch of certificates came through, to mail them to her home upstate. At that time, I called her and said there was $5,000 more of Technical Operations available, do you want them? She said yes. One of the reasons for this --

Q OK, that answers the question.

What about Elco? Did she ever complain that you bought that?

A Absolutely not.

Q Now, during the course of your conversation with her, she mentioned that she had a son who was an attorney, isn't that so?

A Yes.

Q Did she mention at any time between March and

May that she had a nephew who was in the securities business?

A Not quite. She mentioned she knew people in the security business and knew a broker in Buffalo, knew people in the security business, but didn't want people who knew her to know her business. This was basically the gist of it. She didn't want her family in Buffalo or anybody else related to her to know her business, or either her friends in the Buffalo area or anywhere else.

Q Now, a purchase was made of Seaboard securities. What is Seaboard?

A Seaboard is a railroad, a very well-known railroad, that runs along the East Coast, and it has heavy traffic. It consisted of coal and steel with only 2 or 3 percent passenger traffic. It's a very well-run railroad and the stock is listed on the New York Stock Exchange.

Q Did you ever advise Mrs. Grupe that purchasing securities of Seaboard would be a good investment?

A Yes.

Q What securities of Seaboard did you specifically recommend she purchase?

A At one point I called Mrs. Grupe and I said, I know you're opposed to purchasing stock. I believe you can make some money in a very interesting railroad stock;

the earnings are running high. It's a well-regarded stock and we have 1,000 shares in inventory. If you want to use your reserve money for a few months, I believe you can do very well in the next three or four months. I have reason to believe the dividend will be raised, that the earnings for the first five months, and railroads issue their earnings on a monthly basis, were running about $4 a share. This particular railroad could just do that. As earnings go up, they increase their dividend substantially. Conversely, the year before, when their earnings fell, they had cut their dividend. The divident had been cut from $.50 to $.30. I had reason to believe the dividend would be raised at the next meeting, based upon the lift of the company, based upon the earnings that were coming over the Dow Jones tape, and we had purchased a thousand shares of this stock, and we had it in inventory for several months. We had purchased it at 30 1/2 or 30 3/4.

THE COURT: Let's not get into the details; it's not worth getting into that much detail about the Seaboard matter. Tell us what happened next.

A It's important in one respect. You bought it at 30, 30 1/2?

A Yes.

Q That would make your cost approximately $30,000?

A Nearer thirty-one, somewheres between thirty and $31,000.

Q Did Mrs. Grupe at any time tell you to go ahead and buy Seaboard for her?

A Yes, that day. She said, "Are you sure I'm going to be safe in it?"

I said, "I'm sure you'll be safe. Don't be concerned about it, it's a good railroad. The reason I'm asking you to buy it, I think you can make 5 or 6 points on it within 3 or 4 months."

THE COURT: When did this happen?

THE WITNESS: In June or -- I have to look at the sheets.

MR. GOLDSTEIN: It happened towards the end of June.

THE WITNESS: About June the 20th, in the area of June the 20th.

THE COURT: That's close enough.

Q Did you purchase those shares for Mrs. Grupe?

A No.

THE COURT: He already testified he had them in inventory.

THE WITNESS: We had them in inventory.

Q Did you transfer them to her account for the purchase?

A What we did, at the end of that day, Seaboard ranged between, I believe, 25 3/4 and 25. The closing price was 25, which means we could have sold it on the market between 25 3/4 and 25, depending on which time of the day. The closing price was 25 and we put the thousand shares in Mrs. Grupe's account at 25 without adding any commissions.

Q You had purchased those for 30 and sold them to her for 25, that meant you lost $5,000 on that deal, is that correct?

A Yes. In addition to that, we paid a state tax of $50, but that's a tax that has to be paid on the sale of any stock.

Q Did you get that tax back?

A No.

Q Subsequently, did Mrs. Grupe pay for the securities?

A No.

Q What did you do?

A We had to cancel the transaction. When money doesn't come in when it's due, we are compelled by regulations to cancel the transaction. Unlike the other transactions that Mrs. Grupe had where she paid for them on time, we didn't receive a check. I felt embarrassed about calling. I hadn't heard from her and we decided we had to cancel it because the regulations provided for cancelling any transactions not paid for on time.

THE COURT: What regulations?

THE WITNESS: The NASD and FCC regulations. When a stock is sold, your Honor, it must be paid for within five trading days.

THE COURT: You are obviously subject to the FCC regulations because they are federal law.

THE WITNESS: Right.

THE COURT: What bearing upon you does the FCC regulations have?

THE WITNESS: Substantially the same, because the NASD is merely an arm of the FCC, except it's run by the industry.

THE COURT: Are you a licensed security dealer?

THE WITNESS: Yes.

THE COURT: Are you a member of the NASD?

THE WITNESS: Yes.

THE COURT: You are familiar with its rules?

THE WITNESS: Yes.

THE COURT: I think that solves your problem for you, Mr. Blum.

MR. BLUM: Thank you, your Honor.

Q Did you ever press Mrs. Grupe for these moneys for Seaboard?

A No.

Q Subsequently, did the dividend go up on Seaboard?

A Yes. At the next meeting the dividend was raised to $.55 quarterly.

Q You testified that you spent -- how many meetings did you have with Mrs. Grupe between March and May?

A Somewheres between eight and ten meetings. The meetings were practically weekly from about the third week of March, except for a period in May when we skipped a week. There is just the possibility there may have been another week that I skipped because I had to go to California. I don't recall the date.

Q Approximately how many hours did you spend with her at each meeting?

A Anywheres from two to three hours. On one occasion, it was four hours, but the discussions were never completely on securities; at least an hour to two hours were on securities.

Q Did you check -- strike that.

Did you go deeply into Mrs. Grupe's finances with her?

MR. BLUM: Again, your Honor, I think that question is leading and objectionable as to form.

THE COURT: It's conclusory. What discussions did you have with her about her finances?

THE WITNESS: I asked Mrs. Grupe many questions in order to get a picture of her finances, because this is one of the requirements, know your customer. If somebody just has a thousand dollars and that's all the money they have, and they want to come in and buy stock at 90 cents a share **in Canada,** even if somebody has a hundred thousand dollars we don't take orders for 90 cents a share. If they wanted to buy, I would say, in the first instance that's gambling. There are speculative stocks over the counter, and also on the New York Stock Exchange and American Stock Exchange, selling for a dollar, dollar and a half, one would have to assume to be speculative.

In those instances, one would have to know your customer. It's not proper to put someone in an issue of that kind. It's important to know something about the background and financial situation. By questions to Mrs. Grupe were, "Bea, what reserve money do you have?"

She said, "I have sufficient reserve. I have two accounts and I'm getting my salary. I have one account I don't want to touch, and I have another account I can touch. I'm getting a pension. I'm getting my salary. My son owes me $11,000, he gave me a note for it. I want to live a little, but I do need income."

I got the picture. She told me about the settlement, about the $138,000, so I got the picture of what her background was in education, what her background was financially, and what her assets were. She had a home in the northern part of the state. She had a lot in Florida. She had a stock certificate for which she paid $500, but basically I asked her whether she had a will. This might seem impertinent; this is a question normally asked. She didn't have to tell me, but she said yes.

I said, "Could you tell me who your beneficiaries are?"

She said, "My three sons."

"Could you tell me who the executor is?"

"Of course. My son, the lawyer."

I said, "Why don't you let me talk to your son."

MR. BLUM: Your Honor, I think we had this verbatim on Monday.

THE COURT: We did.

MR. BLUM: May I object to it as cumulative.

THE COURT: Yes. Move on to something else.

Q Mr. Lamula, it could be fairly said, then, that you spent approximately sixteen to twenty hours speaking to Mrs. Grupe just at these meetings, isn't that so?

A I spent at least twenty hours, which is considerably more than -- probably ten times more than I spent with any other client.

Q In addition to that, you spoke to her various times over the phone?

A Yes.

Q In addition to that, you had to review the securities for her, did you not?

A I reviewed the reports and the proxy statements. When the securities came through, they were mailed to her.

Q You were a marketmaker in all these ventures, is that correct?

A Yes.

Q Were you a marketmaker in these debentures back in March of 1974?

A Yes.

Q Now, assuming you were very nefarious and out to defraud Mrs. Grupe, out to defraud her and take her money, couldn't you have done it in a much shorter time?

MR. BLUM: Your Honor, I'll concede he didn't break any records in defrauding Mrs. Grupe. The question is whether or not he got there at the end.

A Mrs. Grupe would have purchased securities in the beginning.

THE COURT: Are you making an objection?

MR. BLUM: Yes.

THE COURT: I sustain the objection.

Q You might have been able to sell these securities to Mrs. Grupe after the first meeting, wouldn't you have been able to?

A Yes.

Q Perhaps after the second meeting --

A Yes.

Q As far as the securities themselves, for instance, Technical Operations. I believe you mentioned you were familiar with some of the officers and board of directors, isn't that so?

Before we get into it, what is the definition of the term "outside director"?

A An outside director is a director who is not employed by the company, but may be an official of a bank, may be an official of another company, may be an official of an insurance company.

An outside director is one who is asked to join the board for some expertise that he may have. He may be able to help the company in banking, he may be able to help the company in some other way, in helping to make decisions. A lot of companies have, as directors, some of their officers and some outside directors who were not officials of the company.

Q For instance, Technical Operations, did they have outside directors on their board in 1974?

THE COURT: We seem to be spending an inordinate amount of time on something that seems of trivial consequence.

A Mr. Albert Kelley, who is the dean --

Q Just a minute.

A -- Mr. Albert --

Q Just one minute, please.

MR. GOLDSTEIN: The reason for this is we have the burden at this point of showing these are quality companies. The only way we can do it is by indicating what the companies were all about and perhaps showing who some of the outside directors of the company are. We are not going through every company on this. We are just going to hit a few.

THE COURT: I thought you went over the values of these debentures in great detail on the last court date.

MR. GOLDSTEIN: Not the individuals and who they are associated with besides these companies.

THE COURT: You want to cite who the outside directors are of Technical Operations, do so.

A Mr. Albert Kelley, Dean of the School of Management of Boston College; a Mr. Milton Lauenstein, President and chief executive officer of Ventron Corp., Massachusetts, manufacturers of chemicals; Mr. Frank Marx, former Vice President of American Broadcasting Company. He was put on because American Broadcasting Company and Technical Operations each have 50 percent of a subsidiary called ABTO.

MR. BLUM: Your Honor, I move to strike the last piece of testimony, unless Mr. Lamula can show us how he knows why, or why these were put on.

THE COURT: I think he has told us that company owns each half of a subsidiary, he a-sumes that. I believe it's a reasonable assumption. I believe we are getting pretty far afield.

Q Mr. Lamula, just one other company, Applied Data. To save time --

MR. BLUM: Why don't you tell us the name? I'll accept it without any question.

A I have it here.

Q Tell us who the director is, the outside directors, and what their normal position is outside of the company.

A John Kramer, who is general counsel of the Educational Department Service of Princeton, New Jersey; Malcolm Magna, who is Vice President of the National State Bank of Elizabeth, New Jersey. These are the two key outside directors and all directors as a whole own 216,000 shares.

Q Mr. Lamula, if you would go throuch each and every company, you could pick out such men on each and every company, isn't that so?

A I would be able to pick out two to four outside directors, and I would be able to show that all of the directors have from two to four hundred thousand shares of stock, and in some cases own debentures in these companies.

Q In the spring and summer of 1975, what was the state of the stock market generally?

A The market was in a very bad situation because of the uneasiness over the events in Washington, over the question of whether the President would be on trial for impeachment, and/or whether he might resign. We were having a very bad down market in all securities of all qualities.

Q Were A and AA and AAA securities affected by the downturn?

A Very much so. There were many A, AA bonds of leading companies that fell from 30 to 50 to 60 percent.

Q Could you just tell us the names of a couple of them, and give their ratings as given?

THE COURT: I don't really know it's worthwhile spending a lot of time on it. I believe the plaintiff's expert testified to the same thing.

MR. BLUM: I'll concede it.

MR. GOLDSTEIN: What I attempt to show is the extent of the fluctuation in some of these so-called AAA and AA. I think the jury is given the impression they are rather conservative issues and don't swing as much as .. some of the companies Mr. Lamula purchased.

THE COURT: I think the testimony was on the average they are not affected. However, you can certainly select some of them that did experience swings, particularly if they were affected by the energy crisis at that time, or if they were affected, one way or the other, by impeachment proceedings. I don't think it establishes anything to pick out a few, if they did or didn't. The entire market was in a depressed and chaotic situation. It would have affected all stocks to some extent, and all debentures to some extent, and certain ones more than others.

It would accomplish very little to pick out a few of AAA or AA. That would invite Mr. Blum to pick out a few hundred that didn't experience any change.

THE WITNESS: Your Honor, I only want to read out three or four. This is a list that could run 300.

MR. BLUM: May counsel speak for his client?

THE COURT: You are allowing Mr. Blum to bring in a few hundred that didn't.

MR. BLUM: There is a long list, of General Motors and GMAC, that could have been bought at 80, AAA.

MR. GOLDSTEIN: All right.

Q Mr. Lamula, when did the Inflight debentures come out that Mrs. Grupe purchased?

A In 1968.

Q Now, subsequent to that and before she purchased the securities, did they have a public offering of their stock?

A Yes, there was an additional offering of stock in 1971 by Burnham & Co.

MR. BLUM: Your Honor, we had precisely this testimony. The testimony came out to $3.50 a share. In fact, I'll concede they realized $2,243,000 for several hundred thousand shares issued, or $3.30 a share net. Does that make it easier?

MR. GOLDSTEIN: No.

MR. BLUM: I withdraw my concession, your Honor.

Q Burnham & Co. was one of the underwriters?

A Yes.

Q That was the predecessor of Drexel & Burnham, Mr. Rowney's company?

A Yes.

Q Did they have to issue an offering circular in connection with this offering?

A Yes, they had to issue a prospectus. A prospectus is required by the SEC which gives all of the background of the company, the history from the very beginning, and has to tell of all their assets and liabilities, and gives much more than even the ordinary report. That prospectus must be given to anybody who purchases the stock.

Q The debentures that Mrs. Grupe later purchased came ahead of the common stock being offered?

A Yes. The prospectus would show that extra money they were getting was going into the company, and as a **practical** matter it would strengthen the company because they were issuing common stock.

MR. BLUM: Again, your Honor, there are ways of bringing this out.

THE COURT: Where are you going with this?

MR. GOLDSTEIN: I think this question will indicate it.

THE COURT: I hope so.

Q In the offering circular, didn't Burnham & Co. have to tell the public how great the debentures were in order to sell the stock?

MR. BLUM: Objection, your Honor.

THE COURT: Sustained.

Q Isn't it a fact the offering circular only says good things about the debentures?

MR. BLUM: Objection, your Honor.

THE COURT: Sustained.

MR. GOLDSTEIN: At this time, Mr. Blum, do you have the exhibit -- I don't know which number -- which shows Mrs. Grupe --

MR. BLUM: Yes, the one which we duplicated.

MR. GOLDSTEIN: Yes.

MR. BLUM: You're talking about the purchase ones?

MR. GOLDSTEIN: Yes.

MR. BLUM: Do you have a copy of this?

MR. GOLDSTEIN: Yes.

MR. BLUM: That's Exhibit 65.

Q According to the yellow sheets listing, we have quotes on Allegheny, which is the first company, for May 21, May 22, and May 23. Now, Mr. Lamula --

MR. BLUM: Also May 24. I think it was by error that date wasn't inserted.

Q All right, May 24. Mr. Lamula, to simplify matters, Mr. Blum and I have already stipulated to the purchase price you paid for the securities which you later sold to Mrs. Grupe. For instance, on April 10 you purchased for inventory 10,000 shares of Allegheny at $470 a bond. On May 29, you purchased -- well, May 29 -- strike that.

May 29 is the settlement date. What date would you have purchased the securities?

A The settlement is May 29.

Q The bond that you purchased for your inventories?

A Yes.

Q What date would you have transacted the purchase of those for your inventory, realizing there was a Memorial Day holiday in between?

A May 21.

Q In other words, two days before you sold them to Mrs. Grupe?

A That is correct.

Q On May 21 when you purchased 20,000 shares, you paid $510 per debenture; that's been stipulated.

According to the yellow sheet, Murphy & Durieu were quoting 44 to 49 on the 21st. Wechsler & Krumholz had no quote. Carl Marks & Co. had 45 to 50.

Assuming these yellow sheets were correct and the highest price is 50, would you have paid fifty-five hundred and ten dollars for your own purchase for inventory?

THE COURT: Coulsel, you're cropping your decimal so as to make it rather confusing. Either you have to deal with these as they quote them, which is in terms of thousands, or you'll have to bring them out accurately. Don't jump from fifty to fifty-five hundred. If it was fifty, fifty-one, five hundred, five humdred ten.

Q Yes. Would you have paid 51, which is a point over the highest price quoted in the cost sheet?

A Of course not.

Q This is for your own account?

A Yes.

Q There wasn't any quote that was close to 51, so therefore it would have been ludicrous, assuming the yellow sheets -- I'll strike that and withdraw the question.

DWG, there were no quotes, so that we can't go into. The next is Applied Data, again there are no quotes, so we'll skip over that. The next is Arwood. May 21, according to the stipulation, you paid 47 for your share, the ones that went into inventory, yet on May 21, according to the yellow sheets,there was a quote from Murphy & Durieu for 43 to 47 and no other quotes.

If you were purchasing this, and this is for your own account, would you have paid 47, which is the highest price quoted by Murphy & Durieu, for $20,000?

A No.

THE COURT: I don't understand that.

MR. BLUM: Me either.

THE COURT: It's the only one quoted.

Q Mr. Lamula, how would you have managed to pay less?

A By shopping around.

Q There would have been lower quotes, assuming the yellow sheet is correct?

A There might have been, I don't know.

Q Would you have gone into the sheets yourself?

A Very definitely.

Q What would that mean, going into the sheets?

A We would list our name and we would show we were buyers, hoping that people who might be sellers would come to us and ask us what we would pay for them.

THE COURT: Let's stop here a moment. In fact, you did buy on or about May 20, 21, 20,000 shares of Arwood?

MR. GOLDSTEIN: Yes.

THE COURT: He paid --

MR. GOLDSTEIN: 47.

THE COURT: From whom did he purchase them?

THE WITNESS: From a house that came into us.

THE COURT: Which house?

THE WITNESS: One of the brokerage houses that did not make a market on it.

THE COURT: It was nonmarketmaker from whom you purchased it?

THE WITNESS: Yes. Many times was, many of the large houses, Merrill Lynch and Bache get large orders from their customers. What they do is shop around from the brokers who do make a market. If they have more than five to sell, they try to show their hand, they try to tell us exactly how much they have in order to negotiate a price.

THE COURT: What I don't understand, Mr. Goldstein, he went out and bought on the market, over the counter, on or about May 21, the security at exactly the price being quoted by Murphy & Durieu. What point are you trying to make?

Q Mr. Lamula, you purchased them from a nonmarketmaker, is that correct?

A Yes.

Q Using Murphy & Durieu's figures, 43 to 47, and assume for the sake of argument those are correct. You are Murphy & Durieu. Merrill Lynch calls you up and say they have twenty bonds to sell. Using Murphy & Durieu's figures, what price would you quote to them?

A We would try to get it for less, because they had twenty bonds to sell.

Q Assuming 43 to 47, and assuming that you had to use those figures for at least 5 units, what price would you quote?

A We'd have to quote at least 47, but we'd try to get more.

THE COURT: I still don't understand the point you are making.

MR. BLUM: I think he made a useful point. You have to pay a little more when you want to get a larger number.

THE COURT: Murphy & Durieu would have to sell 5 as I understand it, at 47. If you went in and said, "I want to buy 20," Murphy & Durier would say 47 for the first 5, but 48 and 49 for the next 15. Am I correct?

THE WITNESS: Yes. When I said more, your Honor, we could negotiate. Sometimes what Merrill Lynch does, if I might explain this, if they have a large block of stock to sell, they prefer not to go to five or six dealers. They prefer to go to only one dealer, even though they know the market is 50, 55, an assumed figure.

They know the market, but they will say, "How much will you pay me for 50 bonds?" In that case, we might say 48 or 47, which would give us a good buy. That's becaus we would be taking it at 50 and taking the risk.

THE COURT: I understand. The point I'm making to your counsel is you did reasonably well getting all 20 at the quoted yellow sheet price, and not paying anything above that, even though you were buying four times the amounts that the only trader listed in the yellow sheet was offering at that point.

MR. GOLDSTEIN: We want to show both sides and any sucurities so we don't miss any.

Q Now, with Inflight, on May 21 you paid 38 for 20 bonds. Yet on the yellow sheet on May 21 Wechsler & Krumholz were 28 and 21; Murphy & Durieu were 29, 30. You paid about 7 points over the highest quote. Does that sound logical to you?

A We paid the going price.

Q The going price was not that quoted in the yellow sheet, is that correct?

A Absolutely. We would have never paid the 38.

Q Now, Knight Industries there are no quotes; we'll skip that one.

Lincoln Mortgage, on May 21, according to the stipulation, you paid 51 for 19 bonds. On that day, the only quote was by Wagenseller & Durst, for 43, 50. You paid 1 point above their highest price.

MR. BLUM: Which one is this?

MR. GOLDSTEIN: Lincoln.

Q Would you have done that, assuming the yellow sheets were the prices that were to be quoted?

A How much did we pay?

Q 1 point above their highest.

A 1 point above their highest?

Q Yes.

A No, we wouldn't pay 1 point above their highest.

Q On Nortek, on May 21 you paid $44 for 20 bonds, yet at that time, according to the yellow sheet, Wechsler & Krumholz was quoting 38 to 42. No quote by Murphy & Durieu. You were on the sheets for 37, 43.

THE COURT: I'm telling how much he paid for Nortek because there are two purchases.

MR. GOLDSTEIN: Nortek is only one.

THE COURT: I see two from here.

MR. BLUM: There was a sale.

THE COURT: I can't read that.

MR. BLUM: He bought 20 and sold 5.

THE COURT: He bought at 33?

MR. GOLDSTEIN: Bought at 44.

MR. BLUM: And sold to her at 53 two days later.

THE WITNESS: On which day did we buy?

Q May 21 you bought it at 44. On that date the highest quote was by yourself, 37 to 43. Wechsler & Krumholz were 38 to 42. Would you have paid 1 point over what you were quoting and 2 points over what Wechsler & Krumholz were quoting?

A No.

THE COURT: I don't understand the question. In fact, he did pay. Your questions are not making sense.

MR. GOLDSTEIN: Our contention is, as I believe we are showing through Mr. Lamula, the yellow sheets are not indicative of the price being quoted.

THE COURT: Then you are not asking your

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questions properly. What you're attempting to establish is that when he bought, he paid slightly above the figures quoted in the yellow pages, and in fact he did do this, which indicates the yellow sheets are not accurate when you buy more than the minijum they have to sell at that price, which I believe is 5 in every instance. Isn't it 5?

THE WITNESS: They must sell or buy 5.

THE COURT: The way you are phrasing these questions, you're making it seem like he did do what in fact he did do, which is pay more than the yellow sheet maximum price.

MR. GOLDSTEIN: I want to go through each one and then ask Mr. Lamula a few questions as to the yellow sheets, etc., based upon his testimony.

THE COURT: You're not asking questions you're getting answers for. Move on to Technical Operations.

Q Now, Technical Operations, on May 21 you purchased 15 for 75 a bond. Yet at that time Wechsler & Krumholz were quoting 72 to 74; Wechsler & Cory 68 to 72; John Lamula, 68 to 74. Assume again you had purchases there, you wouldn't have paid 1 point above for all?

A No.

Q Now, at this point, assuming these quotes were the price that had to be paid. Assuming you went to Wechsler & Krumholz and they had to buy at least 5 from you at 74, wouldn't your records reflect that fact?

A Yes.

Q And then the next 5 they could give you a different quote?

A Yes.

Q Your records would reflect that?

A That is correct.

Q Your records wouldn't reflect you bought all 15 at 75?

A No.

BY THE COURT:

Q Who in fact did you purchase the Technical Operations from?

A One of the other houses, one of the nonmarket houses.

Q You paid 75 to them. If you had bought 5 from Murphy & Durieu, 5 from Wechsler & Krumholz, you could have averaged 73 for those purchases. You would have still had to go somewhere else for the additional 5?

A Those quotes were on the sheet. In going to them we got higher quotes.

Q I thought they were compelled to sell 5 at the quoted price.

A If they quoted it, but they do not have to quote the price they showed on the sheets.

Q You've lost me.

A May I explain?

Q Yes.

A The quotes that are submitted this morning appear on tomorrow's sheets.

Q I understand that.

A Something could happen during the day today or overnight, a good earning report could come up.

Q I understand that.

A Therefore, whatever the quote is on the sheet, it could be changed.

Q I understand that. With Wechsler & Krumholz and Murphy & Durieu, their quote, instead of going up from 21 to 22, either stayed the same or went down slightly. Secondly, it would seem if you had gone to them they would have been compelled to sell to you at least 5 bonds at the quoted price.

A Those were not the quoted prices, this is what my point is. The quoted prices were the prices we got from them when called, and they were clocked in on the back of our blue sheets.

Q You're saying the yellow sheets have no importance whatever and no one pays any attention and they quote whatever they feel like, whenever they feel like?

A They change their quotes on either purchases or sales and news that may develop, either good news or bad news.

Q They are not committed to buy or sell 5 shares?

A They are committed to buy or sell on the quote they give you at the minute. If I were to call any one of the houses, including Burnham, on any issue they make or marketed, they do not know whether I am a buyer or seller.

Q I understand. If they make a quote, they have to sell you at least 5 or buy 50?

A Yes.

Q They are committed to stand by the quote. If you call on a yellow sheet price and they change it drastically upwards or downwards, they are stuck with what they quote to you over the phone, but not what they have in the yellow sheet?

A Your Honor, we call the company on an issue about four or five months ago and their quote on the sheet was 55, 60. They came into us, we knew they were 55, 60, and they gave us -- we gave them the same quote, 55, 60.

They said, "We'll sell you 50 bonds at 55." My brother made the mistake of buying the 50 bonds at 55. None of these, your Honor. It turned out fifteen minutes before that there had been some bad news on the tickertape. We didn't catch it. They were sharper than we were, and we were stuck with that purchase because those bonds went down some 25 points.

THE COURT: I understand that. What was Monroe purchased at? There are no quotes on Monroe, so it's not important.

MR. GOLDSTEIN: Yes. The Elco within the yellow sheets and second Technical Operations, we don't have to go through those.

THE COURT: I'm still a bit puzzled about this yellow sheet quote business.

MR. GOLDSTEIN: That's where we are going to.

THE COURT: Are you going over his own quotes of the yellow sheet?

MR. GOLDSTEIN: No.

THE COURT: I will, then.

BY THE COURT:

Q With respect to Allegheny, on May 21 and again on May 23, you were advertising in the yellow sheet to sell at 48. However, during that same period, you sold

Mrs. Grupe at 59. How do youexplain such a variance between what you were putting in the yellow sheets and what you sold to your own customer at?

A We wouldn't follow the yellow sheets. That wasn't the accurate price.

Q Why did you put that price in the yellow sheet?

A That price was in for several days in a row. In some instances where we don't have time to give the sheets, and we don't have time to give the quotes in, the prices of prior days are repeated.

Q You're not accurate about that, Mr. Lamula. As a matter of fact, there is a price here on the 21st, there is no price on the 22nd, and there is a difference of price on the 23rd.

Q May I explain this, sir? That's what I'm asking you to do.

Q Id I called a broker who gave me a quote that was lower than the quote that we would make, instead of selling from inventory, we would buy from the broker and sell as an agent.

Q I understand that. I'm asking you why you are advertising in the yellow sheet, and not just because you forgot to change it, because you did change it. Why are you advertising that you would sell at 48 at the very same time you sold to Mrs. Grupe at 59?

A The answer is we would not have sold at 48, but we would have purchased whatever price we could buy them at.

Q I don't understand your answer. But, moving on to Inflight Services, during this same period, you are listing a price of 33, that you will sell at 33. In fact, you sold to Mrs. Grupe at 41. How do you explain the difference between the price you're quoting in the yellow sheet and what you in fact charge your customer?

A That, we would not have sold at 33.

Q You were advertising that price in the yellow sheet?

A Yes, but we would not sell at 33. It was an attempt to obtain inquiries. We paid more for them.

Q Is the same true on Lincoln Mortgage, which you quoted at 48 and you sold at 56?

A Yes. This is one of the ways in obtaining inquiries and hoping to have people come in to ask for quotes. Sometimes people don't ask for quotes, they come in and say, "We are interested in buying 20 bonds," or selling 30 bonds, particularly when it's more than 5 bonds. This is the important thing with a house like Merrill Lynch or Bache or some of the larger houses. When they get orders from their customers, your Honor, they try not to sell at various prices. They are either willing to sell or buy a block, at either a lower price or a higher price, so they show one price for the 50 bonds they had to sell or the 20 bonds they wanted to buy.

Q This sounds like Satan advertising in the yellow pages -- yellow sheets. You're putting in prices you don't intend to sell at, to get inquiries. When they inquire, you tend to change the price.

A This is a problem we face our competition with, otherwise we get clobbered, the way we did in this other instance I related to you.

THE COURT: Go ahead, Mr. Goldstein.

DIRECT EXAMINATION (Continuing)

BY MR. GOLDSTEIN:

Q Mr. Lamula, as I understand it, the main purpose of going into the yellow sheets is to show you're a marketmaker in that item.

A Yes.

MR. BLUM: Objection. I don't think the witness can testify to this.

THE COURT: I'll allow it.

A Yes.

MR. BLUM: Your Honor, may I have that last question and answer read back? May I ask the Court's indulgence on that?

THE COURT: Yes, unless you objected to a question you didn't hear.

MR. BLUM: No.

THE COURT: Read him the question.

(Question read)

Q Mr. Lamula, let's go back to your meetings with Mrs. Grupe. Did you see Mrs. Grupe sometime toward the end of July 1974?

A Yes.

Q Do you remember the first time she spoke to you towards the end of July 1974?

A Yes.

Q What was the occasion -- withdrawn.

How did you first speak to her, over the phone or in person?

A Over the phone.

Q Do you remember the substance of the conversation, and if so, what it was?

A She said she was coming to New York, spending a day or two, and going out to see her son in Jersey. I then asked her to call us when she came in and I would arrange to meet her and have lunch with her, or dinner.

Q Let me get this straight. She said she was calling to say she would be coming to New York?

A Yes.

Q She wasn't in New York at that time?

A The first call, no.

Q Subsequently, did you hear from her when she was in New York?

A Yes. She called. I wasn't in at the time and I called back.

Q What was the substance of your conversation at that time?

A That she was in New York. I asked her how long she would stay and she said a day or two. I said, "I have something tonight, but can you have dinner?" And she said, "Yes."

I said, "Let me call you back and change some appointments I have."

I did call back and make an appointment for dinner, after having changed a prior appointment and pushed it off until the following week.

Q This was sometime July 29, July 30, around there?

A I had occasion to look at my diary, and also because of Mrs. Grupe's testimony, which helped refresh my recollection, it was either July 29 or 30. It was a Wednesday night.

Q Subsequently, did you pick her up for dinner?

A Yes, the appointment was for 7. When I drove up to the Hilton, within a minute she came out.

Q Where did you go to dinner?

A A restaurant called Marta, on Washington Square Place.-- Washington Place, in the Village.

Q During the drive down to Marta's, did Mrs. Grupe mention anything about the securities she was holding?

A No. We talked about how long she is going to be in New York and what she is going to do. She said it would only be a day or two and be going to New Jersey.

Q Did there come a time during the evening when she brought up the debentures that she had?

A After we had been in the restaurant for about two hours or two and a half hours, Mrs. Grupe said, "John, I didn't really come here to go to my son's. I came here because I'm troubled about my debentures, and I'm very worried about them. I discussed them with" -- I don't know whether she said some broker or relative, I don't recall that part.

Q And what was the conversation following that, if you remember?

A I said, "Bea, I would like you to tell me who you discussed them with so that I may discuss them and give them my side of the story. It may be they don't know enough about these securities or they don't know as much as I believe I know, and I might be able to persuade them, by showing them a lot of material and by discussing the matter with them, that they are safe for you."

Q What was her response?

A She said she would think it over. At that point, we left the restaurant. There were casual conversations. She wanted to see some more of the Village. We walked for about an hour through Washington Square, looking at the building of New York University, which she said she hadn't seen for a long time. I said, "Bea, I'm going to take you back to your hotel. I have to go to Washington tonight, but I'll be back in the morning. I'll be there for a two-hour meeting. I'll be back by noon. I'd like to see you tomorrow afternoon and I'll call you when I come back."

Q During your walk through Greenwich Village, were any other conversations had about the debentures?

A No. She did say one other thing at dinner. She said, "I would like to get out of all of these tomorrow."

I said, "That would be a tragic mistake. You can't dump all these bonds on the market. Just hold off and let me talk to you again tomorrow. If you're adamant and want to get out, we can work it out over a period of time. Wait until I see you tomorrow."

Q Now, you said"over a period of time." Couldn't you have sold all the debentures the next day?

A We would have gone on the sheets -- we were on the sheets. Some of these debentures I could have sold to other clients who already had them and would have taken some more. In most cases, had we sold them on the market, I would have guided myself, and we would have sold them at the offer price, or perhaps a half a point below the offer price, Assuming there were four dealers who all had the same price, we would have quoted a half price below the offer price.

MR. BLUM: I can't tell whether this is a yes or no, and I thought it was susceptible to being answered with a yes or no,

THE COURT: He already answered he has. Continue.

Q Subsequently, did you see Mrs. Grupe the next day?

A Yes.

Q About what time?

A I called and made an appointment to be there later in the afternoon, at about the time the market closed. I went to her room -- I went to the hotel about 4 o'clock. I did phone from the lobby --

MR. BLUM: Again, now I think it's time to say he's answered the question and perhaps another question can be asked.

BY THE COURT:

Q We want to hear about your meeting the next day. What occurred?

A I called from the lobby. I said, "I'm downstairs, Bea. She said, "Come up," and I went upstairs. When I got to the room, I left the door slightly ajar, five or six or seven inches, and this is something I always do when I go to meet any person in a hotel room, and particularly a lady, and it's for her protection. I had with me copies of the reports in an envelope.

I said, "Bea, let me go over these with you again. You have since received several checks. Let me go over Elco with you again, let me go over Technical Operations. It has a radio station in your town."

There, I showed, that the officers of the corporation and the directors had some $35,000 in debentures and some 300 shares of stock, and I went through each one, again showing who the outside directors were, showing in some of these companies the officers and directors had 300 or 400 shares of stock and in some cases they had preferred stock, and both the common stock and preferred stock come after the debentures.

I said, "Here are companies with a very nominal debt. Technical Operations only has a debt of $4 million and their volume is 100 million. They're making a profit. The officers have some 400,000 shares of stock. There are outside directors who are very prominent people and we come before them with our 4,000 shares of debentures. My sister has these debentures. My father-in-law has them and my aunt has them, and they have them at higher prices because that was the market. They have them in the 80's."

I said, "We are perfectly safe. This company, that only owes $4 million in debentures, must begin to buy 8 percent ayear, $320,000, beginning February of 1976, so they have already purchased the 8 percent."

BY MR. GOLDSTEIN:

Q After you had gone over this with Mrs. Grupe, did she have any comment?

A She said, "Very well, I'm satisfied."

I said, "I'm not. I do have to get to a meeting."

By that time it was 7 o'clock. I was there from 4 to 7. I think at one point I said I was there for two hours or an hour and a half, but I was there from 4 to 7.

I said, "Will you do me a favor and come to the office tomorrow, I want to show you some other records we have in the office we can't take out of the office."

I was actually referring to records of relatives and other clients and neighbors, primarily relatives.

She said, "Well, I'm busy in the morning and I'll call you."

We reached her about 12 o'clock. She hadn't called and we called her and we did get her. She said, "I'm going to be tied up, but I'll get down there sometime this afternoon."

Then from that point on we made a number of phone calls. She didn't appear by 3. We called at 3 and at 4 and 5 and waited until almost 6 o'clock. Later that night I found out she had checked out.

Q You didn't speak to her again during the month of July?

A I didn't. She called the office on the following Monday --I wasn't in that morning -- and spoke to Minnie and told Minnie that she couldn't call --

MR. BLUM: Objection, your Honor.

THE COURT: If this is what the plaintiff said to Minnie, it may be --

MR. BLUM: I'll withdraw the objection.

THE COURT: What did she say, when she called to Minnie?

THE WITNESS: She said, "I'm sorry, I was tied up Friday and couldn't get down. Just tell John I'll keep in touch and ask him to keep in touch with me. We'll keep in touch."

That was August 5.

Q August the 5th?

A August the 5th.

Q Did you speak to her again, subsequently, between the next few days?

A No.

Q When was the next time you spoke to her?

A In November, in Albany, at a party for Miss Emerson, who was retiring at the age of 75, and she is badly afflicted with arthritis and had decided to retire. There were some 1,500 people there and I was one of the speakers there with the Governor.

Q When you sold Mrs. Grupe these debentures, did you take a commission?

A No. You don't charge a commission when you sell out of inventory.

Q If you had purchased them for her on the market, what would your --

A We would have added the normal commission.

Q In other words, over and above the price she bought them at?

A Yes.

Q In addition, if you had bought them at the market -- say, for instance, you called up a marketmaker for XYZ corporation. What would you have said to him? You're now calling him up to sell XYZ corporation. What would your words have been to him when he picked up the phone.

A I'd ask for a quote.

Q He would give you a bid and ask?

A Give me a bid and ask. If I were acting as an agent and buying the bonds on the market, I would buy them at his bid price or try to get them a bid lower or try to buy them at his offer price or try a point lower. The problem sometimes arises when you try to go a point lower, he is no longer bound by the quote given you because you attempted to negotiate, because there are situations where this could be done. We would sell those bonds to the client at that pirce, with a commission, and show on our confirmation slip that we acted as agent.

BY THE COURT:

Q What would the commission be, what percentage?

A We normally charge $10 a bond.

Q A flat bond?

A A flat $10 a bond.

Q You say rather than charging a commission here you took a profit, markup profit, because you held them in inventory at the time you sold to her?

MR. GOLDSTEIN: Your Honor --

A Not only that.

MR. GOLDSTEIN: Mr. Lamula, wait a minute.

Your Honor, with due respect, I must take exception to the Court's word -- of the use of the term "market markup profit." I don't think there has been any testimony as to markup.

THE COURT: All right, I'll withdraw the markup aspect.

Q You sold them to her at a profit, at a price you fixed, because you held them in inventory, having purchased them a day or two before you sold them to her?

A No. We sold them to her at what was indicated to be the going price.

Q I understand how that was arrived at. We heard Miss Vena's testimony about that and what-have-you. I'm saying if you'd gone out and purchased them just to sell to her, you would have charged a commission of $10 per bond. You say that since you bought them a day or two earlier, you were not charging a commission, you were charging whatever you found to be the market price at the time you sold. Even if there was no change in the price, there is a 10 percent change in bid and ask, and virtually assures you of 10 percent there.

A If the price --

Q I take that back. You were buying, therefore you were buying at the bid price. There was no guarantees -- strike that completely.

THE COURT: I tell the jury to withdraw that.

A We have been caught many times where some news comes out overnight on an issue. The SEC may step in or there is a stockhold suit where trading is stopped and we may have 50 bonds in inventory.

Q I understand that. Are you telling us that your purchases of all these various securities on or about May 21 was unrelated to your intent to sell them to her on May 22 or May 23?

A Yes.

Q Completely unrelated?

A Unrelated, because we also had other items in inventory and other items I had discussed with Mrs. Grupe.

BY MR. GOLDSTEIN:

Q Mr. Lamula, with regard to all of these issues, periodically you would purchase for inventory, would you not?

A We would purchase both for inventory and we would purchase as agents.

BY THE COURT:

Q Incidentally, because you correctly pointed out there was no evidence in the record concerning markup, at least from this witness, do you understand the phrase "markup"? Does it have any meaning to you?

A Yes.

Q What do you understand it to mean?

A That if an issue is quoted between 50 and 55 and you sell it out of inventory that your markup should be within a range of 5 percent of the offer price.

Q I wonder what circumstances does that apply in?

A When you are selling out of inventory, and assuming that that is the going market, it should be, your Honor, no more than -- we generally use a figure considerably smaller. It might be 2 or 3 percent, sometimes it's 1 percent. We have never used 5 percent. That applies -- the theory behind it is, if you have securities in inventory and you have had them in at least overnight or a couple of nights, then you are not in the situation where you have had a riskless situation. You have taken the risk of putting these securities in your inventory and something could have happened to these companies that might have hurt their price.

The difference between the bid and the ask is the attempted position. One can sell within a range of -- we generally use from 1 to 2 percent above the offer price.

Q By "the offer price,"you mean that which the market is generally offering at that time?

A Correct.

Q I still don't understand where the phrase "markup" comes from. Cite something in the NASD rules.

A The markup should not be more than 5 percent.

Q You are not supposed to sell more than 5 percent of the offer price as established from the existing market at the time you sell?

A That is correct.

Q Miss Vena quoted theories and prices from telephone calls which were iwthin 5 percent of what you sold to Miss Grupe at. You feel your sales were all within the markup requirement of the NASD?

A I feel they were less. DWG was quoted at 52, 55. We could have purchased that at 55 and added 1 point for commission. The customer would be paying 56. We sold it out of inventory for 54.

Q Of course, this was not great inventory to you since you had, in fact, only purchased it a day or two earlier for 48.

A Yes. This is one of the reasons we sold it below the offer price. On Technical Operations, the actual quote I believe we got was 75, 80. We sold it at 79.

THE COURT: I find the list of quotes that Miss Vena gave to you a little unusual. I cannot understand the fluctuation from what is listed in the yellow pages and that which they will quote you when you call on the phone.

What I find a bit surprising is every one of the quotes she got was substantially higher than the yellow page quote.

MR. GOLDSTEIN: Your Honor, again I respectfully take exception to the Court's statement, but a lot of these were not substantially higher. In some cases there were no quotes and the others --

THE COURT: To the extent there were yellow sheet quotes, I don't know of any quotes that were the same or lower.

MR. GOLDSTEIN: Your Honor, I respectfully refer the Court to Arwood where there were quotes of 43 and 47, and Miss Vena shows 45, 50; 45, 61.

MR. BLUM: That's a spread of 3 or 4 as I counted, your Honor.

THE WITNESS: Your Honor --

THE COURT: Just a minute, please. The order ticket quote, confining ourselves only to the selling price, since that is what we are concerned with, she records 50, 51; the yellow sheets list 44 or 47.

MR. GOLDSTEIN: Not on Arwood.

MR. BLUM: On Arwood.

MR. GOLDSTEIN: I have her 43, 47

THE COURT: 43 is what they will purchase at, 47 is what they will sell at.

MR. GOLDSTEIN: Right.

THE COURT: Confining ourselves with the selling price, which is what is important, she records 50, 51 as being the prices which the marketmakers were offering to sell to her at. However, the yellow sheet records one of those marketmakers during the same period they were offering to sell at 46, 47, which is 3 to 4 points lower than what is recorded.

I think that same pattern holds up on every one where there is a yellow sheet price.

MR. GOLDSTEIN: Your Honor, also John Lamula is listed there for 44 to 50.

THE COURT: I know.

MR. GOLDSTEIN: His 50 would be equal to Miss Vena's quote and he was in the yellow sheet.

BY THE COURT:

Q We are talking about the fact that Miss Vena said she called a number of the marketmakers and they quoted her prices, and Mr. Lamula has explained why the price quoted doesn't always match the yellow sheet price, even when they are bracketed.

Assuming that to be so, why is it that all the quotes were continually higher than the yellow sheet prices? You would expect some variation, some higher, some lower, what have you. Do you have any explanation for that?

A On Nortek, your Honor, the picture changed on Nortek within one day.

Q Nortek definitely chan[illegible], no question about it.

A May I explain why?

THE COURT: At the day she was getting her quote, it was at the lower price. It never came up as high as what she recorded. It was at 42 for two days, went to 50; two days after that she's recording 53. Let's not pursue this. How much longer will you be with this witness?

MR. GOLDSTEIN: Not much longer.

BY MR. GOLDSTEIN:

Q Mr. Lamula, specifically Nortek, can you tell what happened to the change in price in that case, as an illustration?

A On the 22nd, Nortek made an announcement they were going to buy $500,000 worth of their own debentures towards the sinking fund. Immediately, not only did the price go up, many of the dealers dropped out. When we went to them, they did not have any for sale.

In many of these cases, your Honor, they are houses that make a market in three or 400 issues, and they only keep an inventory of 5 bonds. In order to keep a large size, immediately you go into billing. They are out of debentures. Immediately the story came out on the 22nd, the price not only went all the way up, but there weren't bonds to be purchased, so much so that I have a memorandum here that came from the Dow Jones tape from their report at a later date that by the time they bought in the $500,000 worth of bonds at the rate of $75 per bond.

Q Mr. Lamula, just a few more questions --

THE WITNESS: Nortek paid $75 a bond in order to accumulate $500,000 worth of bonds.

Q Just a few more questions.

One question was raised yesterday with regard to your time clock. Is the time clock something that you can change very easily, the date and time?

A It's automatic. The only time it has to be changed is every ten years. That's what happened. We had a ten-year cycle from '64 to '73 and we didn't realize at '73 it had to be changed.

Q The clock kept on saying 1973?

A Yes. You'll find all our trades from January until such time as we realized it. We had to call some specialist who came in.

Q If you wanted to change the date or the time on that time clock, could you or Miss Vena do so?

A No.

Q Why?

A There is no way of doing it, it's mechanically locked.

Q It required a mechanic to open it up?

A There are special people in that field who sell the item.

THE COURT: I wouldn't make a big thing out of this, counsel. It's obvious the date is the date it went through. You can't predate it, but you can postdate it simply by holding it.

MR. GOLDSTEIN: You can predate it, you can't postdate it.

THE COURT: It depends on which it is.

MR. GOLDSTEIN: You can pull out the plug so on the 23rd it will read the 22nd.

THE COURT: When you record a quote, you can hold it a day or two and that would show a couple of days later. There is no way to put it into the machine and record an earlier date.

MR. GOLDSTEIN: Unless you pull the plug and stop the electricity.

THE COURT: I don't know how you would catch up again.

THE WITNESS: We have all transactions on those days. Those were not our only transactions.

MR. GOLDSTEIN: Your Honor, this is a list Mr. Blum and I agreed as being accurate. This shows the sale of L. F. Rothschild.

THE COURT: This compares with what she sold at the yellow sheet price.

MR. GOLDSTEIN: Yes.

THE COURT: What exhibit number is this?

MR. BLUM: Did we give this to the jury?

MR. GOLDSTEIN: I don't think this was shown to the jury yet.

MR. BLUM: I think it was. It's the same one. It's already before the jury as 166. Do you want to take ours? I suggest it only because they are arranged in the order we are dealing with on the line.

MR. GOLDSTEIN: When we photostated them it was changed around.

THE COURT: If you're spending a lot of time on this, I'll take a recess now. Let me suggest it might be worthwhile to rearrange them and put them in the same order.

Ten minutes' recess. Take the jury out.

(Jury temporarily excused)

(Recess)

(In open court; jury present)

THE COURT: Mr. Goldstein?

BY MR. GOLDSTEIN:

Q Mr. Lamula, were there some of these debentures which you subsequently sold back to the company?

A Applied data we sold at $750 apiece to the company for their sinking fund.

MR. BLUM: Objection. Move the answer be stricken. I think Mr. Lamula's subsequent market transactions were these transactions is nowhere relative.

MR. GOLDSTEIN: Subsequent to the position, I think there is testimony what happened with the debentures.

THE COURT: I thought you were in agreement that the suitability of debentures has to be evaluated as of the time or purchase.

MR. GOLDSTEIN: Yes, there is no question on that. There has been some testimony as to what happened with these companies afterwards in an attempt to show whether they were suitable or not, on both sides.

THE COURT: The further away you get from the day of purchase, the less relevance it has. I've asked you twice what time are we talking about?

Q Applied Data, when were the debentures sold?

A We sold 144,000 of Applied Data at $5,750 apiece at the beginning of March.

MR. BLUM: What year?

THE WITNESS: This year.

THE COURT: That's too remote.

Q Were there any other sales in 1975?

MR. BLUM: Again, your Honor, I raise the objection, not only because of the remoteness in time, because Mr. Lamula's particular position with regard to his ability to sell different things is quite different from what the plaintiff would do. Therefore, I think it has no relevance to the question here.

THE COURT: '75 is too long.

THE WITNESS: These were sold for clients, not our inventory.

THE COURT: '75 is too long.

Q Were any debentures sold in '74?

A '75, but for clients.

Q Mr. Lamula, I show you Plaintiff's 17 for identification --

MR. GOLDSTEIN: I suggest it be marked in evidence.

MR. BLUM: No objection.

Q -- 17 in evidence, and ask if you recognize it.

A Yes.

Q What is that?

A It's a letter to Mrs. Grupe dated May 24, 1974.

Q And could you read it, please?

A Yes.

"Dear Bea: You have purchased the various issues that I described to you earlier in the week and you will either receive by mail, or I may have with me, a complete statement. May I again point out that I am not influenced by rating organizations and their so-called AAA bonds, which would only give you an income of 7 or 8 percent without any possible appreciation.

"I believe that inflation alone would take away that much every year.

"I have developed by own method of categorizing debentures which I prefer because they are basically a loan to the company which must be paid on a definite date at par, $1,000 per bond, with income ranging from 10 to 12 percent, with short maturity dates; namely, from nine to fifteen years and with sinking funds already functioning in most of these cases. In some instances, the outstanding debentures are being reduced each year. In others, the sinking fund begins over the next few years.

"As an example, Applied Data: The balance is approximately 1,500,000, which is the sinking fund, requiring the company to purchase $168,000 each year, and the balance due on May 15, 1983.

"Another example is Technical Operations, which does over 100 million a year, showing good profits on their stock, with an issue of only $4 million. The sinking fund commenced February 1, 1970, requiring the purchase of 8 percent per year of the balance outstanding, and then full payment by February 1, 1985.

"Substantially the same approach applies in all of the other debentures that you have purchased, which I have underlined and reviewed with you, in each of the reports left with you.

"Let me again repeat that I have confidence in these issues and that I know the companies. However, your protection lies in the fact that I have spread the money over a total of ten issues. This means you have $170,000 in face amount for an investment of $96,600 and an income of $10,762. With a spread of ten issues, even if per chance something should happen in one case, the balance would protect you and the additional income received over the years would build a cushion.

"I also feel relatively safe when I am able to spread investments over a group of issues and I truly believe you have no concern.

"If you have any questions, please call me or write them down and I will go over them with you when I see you sometime next week."

Q That was sent to Mrs. Grupe?

A On May 24, 1974.

Q That was shortly after you made the purchases for her?

A That was the day after we made the purchases.

Q Mr. Lamula, I call your attention to the set of documents that the jury has, which indicates the sale by Rothschild of the various debentures belonging to Mrs. Grupe. Let me ask you some preparatory questions.

When Rothschild is selling to one of these marketmakers, which price does it get for the debentures, the bid or ask?

A The bid.

THE COURT: Which is the lower one?

THE WITNESS: The lower?

Q If in the case of VWG Corp., second sheet, if Rothschild sold the bonds at more than one price, they would have to indicate the different prices they got, such as they did for DWG?

A Yes.

Q If it isn't indicated, it means they sold all the debentures at the price on the top of the sheet?

A That is correct.

Q Now, on Allegheny, there were bids of 340, 330, 340 and 350?

A That is correct.

Q And the sheet indicates that all the bonds were sold at 330?

A They sold all 30 bonds at 330. What is terribly more important --

MR. BLUM: Objection, your Honor.

THE COURT: Yes.

Q Just answer the question. Now, Carr Securities Corp.

A Carr?

Q Yes. They were given a bid of 350. Carr would have to buy at least five of these at 350?

A At a minimum.

Q If they went to Murphy & Durieu, they could have goteen the same?

A Yes.

THE COURT: I don't understand this. This is in direct conflict with the testimony earlier. He testified earlier the prices in the yellow sheets are not binding and are not required binding. If you make a telephone call, they can change the price any way they feel like, and it's only the price they give over the phone they are bound with. Which is it? The price on the phone or the yellow sheet?

MR. GOLDSTEIN: That is our contention, if Mr. Blum is willing to concede that's it.

THE COURT: He testified he had to sell 5 at the yellow sheet price.

MR. BLUM: I would concede the yellow sneet accurately shows the market value price that day, subsequent to when Lamula is bidding or buying, in what can be considered contemporaneous.

THE COURT: That's a different issue than what I'm raising now.

BY THE COURT:

Q Mr. Lamula, we were just talking about Allegheny.

A Yes, sir.

Q It was pointed out that they sold them all at 330.

A Yes, sir.

Q It was noted that while one marketmaker bid 330, two other marketmakers were bidding 340 and Carr was bidding 350; and you were asked did not Carr have to buy at least 5 at 350, and you said yes.

A Your Honor, if their bid was 350 when they called, Rothschild may very well say that when they tried to sell them the best bid they could get was 330.

Q You indicated that when Miss Vena called the price quoted was substantially higher than bid.

A I indicated the prices were what they are.

Q Does the mere fact Carr is quoted at 350 doesn't mean Rothschild could have sold to them at 350?

A What it does mean, the problem Rothschild faces is a problem we face.

BY MR. GOLDSTEIN:

Q We could go through all of these like that, but rather than do that, Mr. Lamula, I think the jury can see the difference in the yellow sheets and the prices. Let's go to Inflight Services.

Your firm is listed in the sheets as bidding 220 and asking none. What does that indicate to a trader?

A That we're buyers. If they come in to us and offer us debentures, that we may take them at a higher price, that we don't have any to sell.

Q In other words, that you are definitely buying?

A Well, when they see nothing on the outside, they recognize we're buyers, that we will buy, and they know that they can get a better price.

Q A better price than what?

A That whatever is shown on the sheets. They come in and say, "We have 50 bonds to sell at X price."

Q Now, the same would go for Knight Industries and Lincoln Mortgage, would they not?

A Yes, Knight Industries, as being accumulated. If there is only one bidder on Knight Industries, he is accumulating the debentures for the company. I could go directly to the company if I have more Knight Industries. I have clients who do not want to sell them because I agree with them. They come due in '83.

The company is doing well and I suggest they hold onto them to get $1,000 apiece, but there are no bonds to be bought in the market.

MR. BLUM: Again, are we talking about -- never mind.

Q Now, you were familiar with the prices that these bonds could have been sold at in 1974 in the beginning of August, were you not?

A Yes.

Q You have reviewed all these figures very carefully in preparation for this trial, have you not?

A Yes.

Q What do the figures that Mrs. Grupe got for her bonds indicate to you?

A That they were thrown away at any price. They were dumped all in one day.

MR. GOLDSTEIN: No further questions.

MR. BLUM: Objection. They weren't dumped in one day. They weren't sold in one day, but spread out, as the record shows.

BY THE COURT:

Q Some were sold on the 7th but the great bulk of them were sold on the 6th of August?

A The great bulk of them was sold two days before the President resigned and the market was a mess. These should have been sold, and I had offered to sell them, over a period of time.

Q You're not suggesting either Mrs. Grupe or Rothschild knew two days in advance the President was going to resign?

A No. The country was in a turmoil and there was speculation he might resign two days before, your Honor. There was considerable speculation.

MR. BLUM: I'm very happy to have that particular correction, your Honor.

THE COURT: All right. Cross-examination

CROSS-EXAMINATION

BY MR. BLUM:

Q Let me cover certain preliminary things, Mr. Lamula. It was you who first suggested conversations of these debentures, is that correct, to Mrs. Grupe, in your discussions? They were first mentioned by you, weren't they?

A I mentioned a number of names among these.

Q These names were not mentioned by her initially, they were mentioned by you?

A No, they were not mentioned by Mrs. Grupe.

Q Indeed, am I correct that no securities were mentioned by you by name for her consideration except convertible debentures, of which your fund had been or was a marketmaker at one time or another?

A I had told Mrs. Grupe --

Q That's a yes or no.

A Don't you want the facts?

Q I want the answer yes or no. Is it true that no other securities had been recommended by you for Mrs. Grupe, for consideration, except convertible debentures for which your firm was or had been a marketmaker?

MR. GOLDSTEIN: During which time?

Q In any of the meetings in which you made recommendations to Mrs. Grupe before May 21, 1974.

A We were making a market in these securities and other securities.

Q That is not my question.

A I explained that to Mrs. Grupe.

Q My question is: Were these and other securities for which you were a marketmaker or had been a marketmaker the only securities you recommended that she consider during that period?

A Yes.

Q It was you who determined -- withdrawn.

It was you who made the recommendations to Mrs. Grupe of the specific amounts of each of these issues, was it not? The allocation of her available funds among these issues was first proposed by you, was it not?

A I first made a recommendation to go to her own broker and I would talk to her and make the same suggestion.

Q That's not my question. The question is whether it was you who first recommended that the various numbers of debentures that she buy in each of these categories -- I don't want to review the whole list --

A I recommended the numbers she buy on the date of purchase.

Q That was your determination, wasn't it?

A Yes.

Q Let's go back to this question on what date John Lamula Investors really sold the debentures, on May 22 or May 23, to Mrs. Grupe.

A You know it was May 23 and the clock shows it. You want the facts, do you not?

Q May I have Plaintiff's Exhibit 60?

I suggest to you it might have been May 21.

A You're wrong.

MR. GOLDSTEIN: Objection as being argumentative

THE COURT: I'll allow it.

Q Was it May 21?

A You know the date.

MR. GOLDSTEIN: Asked and answered.

THE COURT: If it has, you drowned it out. I couldn't hear the answer. What is the answer?

THE WITNESS: The date was the 23rd, the date the tickets were clocked.

Q I show you Plaintiff's Exhibit 60, an excerpt from Mrs. Vena's diary, and ask you one question: Is that entry for May 21 in Mrs. Vena's handwriting? Yes or no.

A That's her handwriting.

Q Let me read it to the jury. This is Mrs. Grupe's entry on Tuesday, May 21 -- Mrs. Vena's entry on Tuesday, May 21.

"Met Grupe today. Review items purchased 5/21."

A I met Mrs. Grupe that evening and didn't get back to New York, and Mrs. Grupe knows I was with her that evening and didn't get back to New York until Wednesday night.

Q Well, the entry that your secretary made which says, "Review items purchased 5/21" was an error, is that correct?

MR. GOLDSTEIN: Your Honor, I think that should be shown to the jury.

MR. BLUM: By all means.

MR. GOLDSTEIN: I think Mr. Blum is reading it one way and I think it indicates the date is there and does not indicate those were purchased 5/21.

MR. BLUM: Fine.

THE COURT: Does it say "purchased," in the past tense?

MR. BLUM: Yes, and it has the date 5/21 immediately following.

THE COURT: After the jury looked at it, I would like to look at it.

Q Do you have the original diary with you, Mr. Lamula?

A Let me see my briefcase.

Q Mr. Lamula, do you have the original diary with you?

A No.

THE COURT: I think you can proceed while the jury is looking at that.

Q There isn't any question that John Lamula Investors acquired somewhere between 120,000 and 130,000 face amounts of these debentures on May 21, is that correct?

A We acquired debentures on May 21.

Q You acquired between 120,000 and 130,000 on May 21, isn't that correct?

A I don't have the exact amount.

Q Maybe we can take it up again. Was there any time prior to May 21 that you told Mrs. Grupe that you didn't have these debentures in inventory?

A I told Mrs. Grupe at all times that the debentures we were talking about we carried in inventory; that Miss Emerson had purchased them four, five or six years before. I told Mrs. Grupe that we made markets and we carry them in inventory and she wouldn't pay a commission if we had them in inventory.

THE COURT: Did she understand what you meant when you told her you were a marketmaker?

THE WITNESS: I believe so. I explained that we bought and sold the securities for our own account for trading purposes. We sold them to other dealers and we sold them to clients.

Q You heard the testimony of Miss Emerson which was read in, in which she said she didn't know what "marketmaker"meant. She was present at all those meetings, wasn't she?

A Miss Emerson was present.

Q And you do recall the testimony that she gave as it was read in, that she didn't recall what the term "marketmaker" meant, don't you recall her having said that?

A Is that in the testimony?

Q I'll read it to you. It's on page 111.

"Q Now, in a securities sense, what does the term 'marketmaker' mean to you?

"A What's that again?

"Q Marketmaker. Does that term mean anything to you?

"A It means nothing to me. I don't read the market news. It has no relationship to me at all. There is no reason for me to read the market news."

Does that refresh your recollection as to whether you advised Mrs. Grupe that you were a marketmaker for these debentures?

A I did advise Mrs. Grupe. I specifically said these are issues that we know very well. We traded in them and we have them in inventory. We trade in these issues for our own account.

Q I read you from your testimony on your deposition, Mr. Lamula, from page 264, line 16, where I asked you --

MR. GOLDSTEIN: Wait a minute. Does the Court wish a copy of this?

THE COURT: Yes, please.

MR. BLUM: The original is not filed and I don't know where it is.

THE COURT: I think we should explain to the jury something about Exhibit 60 which neither of you mentioned.

There area number of entries on that calendar which have been whited out. I assume they have been whited out because they do not relate to this case.

MR. BLUM: That is correct. We stipulated, Mr. Goldstein and I, at the time these documents were released to us, we would rely on his whiting out only items that had no relevance to Mr. Lamula's personal affairs.

THE COURT: You agree with that?

MR. GOLDSTEIN: We whited out anything that had to do with another matter or something else.

THE COURT: OK.

Q I read from page 264, which, your Honor, is in the third volume, line 16.

"Q Now, all of these securities were placed in her portfolio into that first group of purchases, which had a settlement date of May 21, were from your inventory? You didn't go to the market to cover, did you?

"A No, confirmation indicates they were from our inventory."

Were they in fact sold to her from your inventory, or did you go to the market to cover?

A We sold them from our inventory and our confirmation indicates that we sold them from our inventory and Mrs. Grupe received those confirmations; and there is a number that showed we sold them for our inventory. And the slips do not show any commission, it clearly indicated --

Q Excuse me, that was not my question what the confirmations show. My question to you then, as it is now, did John Lamula Investors go to the market to cover its sales to Mrs. Grupe or did it have them in inventory?

A We had them in inventory. We went to the market to get a price so we could price them.

Q That's the inventory you refer to, the inventory acquired a day or two days earlier?

A And many other securities which were in our inventory, sir.

THE COURT: This is a little unclear to me, Mr. Blum.

BY THE COURT:

Q It's clear by the 22nd or 23rd of May you had these items in inventory?

A We had them for several days, your Honor.

Q When you were speaking with Mrs. Grupe the previous week, you say you told her you had them in inventory. The previous week you hadn't purchased any of these except the 10,000 Allegheny and perhaps one other?

A No, your Honor. I went over a number of issues with Mrs. Grupe. I said, "Bea, we make a market in this, which means we have stocks of this kind in inventory from tome to time. If perchance when the time came Mrs. Grupe was able to buy these we didn't have them in inventory, we'd buy them in the open market on a commission basis. So much so, the real intent was to buy the securities in July.

Q That's different from telling her you were already holding these issues the previous weeks or months or what have you. You didn't tell her that, did you?

A I told her we always made a market in these issues and others and we would constantly buy them from time to time and sell them.

Q Did you tell her a week or month before the trade date that you were already holding these in inventory?

A No, I did not tell her we were holding these in inventory. I said some of these we have in inventory because some of them we did have in inventory a month or two before.

BY MR. BLUM:

Q With that answer in mind, Mr. Lamula, I read to you from page 262 and 263 where there was a lengthy question and answer, starting on line 18, page 262. I think there are some errors in the stenotyping which I'll try to cover.

"Q I think what I want to know is whether the" --

A Could you repeat the page?

Q Page 262, line 18. You have the original transcript there, Mr. Lamula?

A Just a copy.

Q I'll read my answer as put there.

THE COURT: I don't think I'd bother reading the question, it's just so long.

MR. BLUM: Why don't I read the answer.

THE COURT: The answer is important. Ask him: In effect, is this a fair description of the process of the sale, to which he replied --

Q Answer on page 263: "What I developed with her were, these were the issues I thought she should buy; that the hundred thousand dollars should be spread among the issues; the income would range between 10 and 11 percent, depending on the price they were purchased at that we had securities in inventory. And we conducted the inquiries, we would stay within the hundred thousand and like to keep within 10 to 12 percent with the hope that an interest date would fall due every month, at least every month, so she would have income consistently throughout the year."

Again, having finished that, I ask you whether in fact you advised her that you were holding these debentures in inventory?

A I don't understand your question.

Q Did you advise her during the period of time prior to May 21 that you were holding the debentures which you planned to sell to her in inventory?

A On which day?

Q At any time prior to May 21.

A Yes. She knew that we were marketmakers and I explained what a marketmaker was. We bought these for our own account. We sold them to the trade and we sold them to clients. There were times when we had inventory and other times when we didn't have inventory.

Q Let's turn to the certificate of deposit. You testified, if my notes are correct, that Mrs. Grupe told you in one of the early meetings that she had a hundred thousand dollars in a certificate of deposit and that she had been advised that the interest rate was going to go down following July 15 when it was reissued, if it were to be reissued. Did you tell her that there was no way one could tell in February or March or April what the interest rate would be in July on a certificate?

A That isn't true.

MR. GOLDSTEIN: I would object to the question.

THE COURT: Sustained.

MR. BLUM: Your Honor, there has been testimony --

THE COURT: Rephrase the question. It's improper in form.

MR. BLUM: All right.

Q Mr. Lamula, do you agree with the testimony given by Mr. Rowney to the effect that the interest rate on a certificate of deposit is determined at or close to the day in which it's issued?

A Absolutely not. Absolutely not. And Mrs. Grupe told me on that very first meeting, as she told Miss Emerson, that was the reason she wanted to invest the hundred thousand dollars, because she had been told by her friend, the vice president of the Bankers Trust Company, that the rate was going to be reduced upon renewal.

Q That occurred in March?

A That occurred in March. She knew it at that time and that was the reason for seeking out a new investment.

Q Such advice was not contrary to your experience with certificates of deposit?

A No.

Q My notes of your testimony on Monday indicate that you said that you told Mrs. Grupe that all of these debentures were rated B or that they weren't rated. In fact, some of them were rated CCC, weren't they?

A For example, which one?

Q I think we can see Technical Operations.

A Hold it right there.

Q Beg pardon?

A I didn't want to make an issue of this because I believe you're honorable, but you're wrong on Technical Operations and I haven't raised the question.

Q I ask you, was Technical --

A Technical Operations is a B.

Q Is a B?

A Yes. Why did you put CCC?

Q Is a B, or was at the time.

A At the time.

Q Your counsel has stipulated it was CCC.

A That is not so. I did not raise the question because I did not believe that you would do this purposely and I don't believe it now.

THE COURT: Let's confine ourselves to the question.

THE WITNESS: And you've made errors in other ratings.

THE COURT: Mr. Lamula, please stop.

Q Did you at the time you told her that these were rated B, or not rated **B,** read to her or tell her in your own words what the **Major** Rating Service meant by B as declared in their manuals?

A I told her I was not guided by the rating services, that Standard & Poor's showed no rating for Chase Manhattan Bank. They showed no rating for Aetna Insurance Company and showed no rating for American Express Company.

Q That's what you told her?

A Yes, and I said I establish my own ratings.

Q You didn't tell her what CCC meant with regard to Allegheny Beverage, did you?

A I rated it my own way.

Q Did you or didn't you tell her?

A I did not tell her of the ratings.

THE COURT: Did you know yourself as to what the Standard & Poor's was?

THE WITNESS: Yes, I did, but I'm not guided by them because of the things they do with banks and insurance companies and a lot of **major companies, and the** fact you have to pay Standard & Poor's in order to be rated.

Q You were referred to some questions that you asked about Mrs. Grupe's lawyer son and also about a broker in Buffalo. Was the real reason you asked Mrs. Grupe whether she would consult her lawyer son or the Buffalo broker to make sure that neither of them would interfere with your control of her investments?

A That's a despicable question.

Q What's the answer?

A That's a despicable question.

Q What's the answer?

THE COURT: Answer the question.

A Absolutely not. I wanted to discuss it with her broker and I wanted to discuss it with her son and you know it.

Q Mr. Lamula --

A Bob Blum, my life is at stake here, that's how important it is to me.

THE COURT: Mr. Lamula --

MR. BLUM: Mr. Lamula, this lady's money was at stake.

THE COURT: Now both of you stop this right now. We'll have none of this. There will be questions and answers and that's all there will be. Do not argue with each other.

MR. BLUM: I'm sorry, your Honor, I felt a little tried by that.

THE COURT: I'm stopping him and stopping you.

MR. BLUM: Thank you, your Honor.

THE COURT: Keep yourselves to questions and answers.

Q Mr. Lamula, Miss Vena said that -- Mrs. Vena said that your office, at the time that this occurred, your office employed six people. How many of them were full-time employees in the spring of 1974?

A Four were full-time and two part-time.

Q Do you have a research library?

A No.

Q Do you -- did any of those four full-time or two part-time include a research assistant?

A One is, but I do my own research.

Q Who is the research assistant?

A A man by the name of Barry, former employee of the SEC.

Q You do your own research --

A Beg pardon?

Q -- is that correct -- I'm sorry.

A I said a former employee of the SEC.

Q But you said, I think, something. You do your own research?

A I do my own research.

Q Let's turn to discussions about these particular convertible debentures. I think you said that they're all doing very well. I don't intend to review where they are today, but let's take a look at them as they were at the time. Is it not true that Allegheny Beverage Corporation lost $12.5 million in 1972 on gross revenues of $59 million?

MR. GOLDSTEIN: Your Honor, for the same reason Mr. Blum objected before, I would object to this. '72 is two years before she purchased it. I don't see how it's relevant.

MR. BLUM: I will connect it.

THE COURT: I'll allow it for the moment.

Q Mr. Lamula, the 1973 annual report which you gave to Mrs. Grupe contains 1972 figures with respect to the gross revenue and earnings of the company, doesn't it?

A May I look at your report?

(Handing)

MR. BLUM: I don't think this has an exhibit tag on it.

(Plaintiff's Exhibit 168 marked for identification.)

Q My question is whether that annual report reflects the earnings of the company and its gross revenues in 1972.

A Yes, it does.

Q In March or April or May of 1974, that report had been out -- that was the most recent report, the 1973 report?

A The '73 report which shows earnings.

Q That correct. Here you have a company which lost $12 1/2 million in 1972 on gross revenues of 1959, and in 1973 showed earnings of $1 million on gross revenues of $64 million. Did you point those facts out to Mrs. Grupe when you talked with her about -- when you recommended these debentures to her?

A I pointed out that in 1972, notwithstanding the loss, they took $2,382,000 for depreciation, which is money that stayed in the till. I pointed out in 1973, when they did make money, they took $2,736,000 for depreciation, which stayed in the till. I also pointed out, Mr. Blum, that DWG had filed a prospective --

MR. BLUM: May the witness be instructed to limit himself to the questions asked?

THE COURT: Just answer the questions.

MR. BLUM: Thank you.

Q Mr. Lamula, it's your testimony that you told Mrs. Grupe this was a suitable security for her?

A I did tell her it was a suitable security.

Q Even though it had shown small loss in '72 and slight earnings in '73?

A Because I had with me --

Q Yes or no.

A I pointed out the depreciation and I had with me the report of '73. We are now talking about '74, sir.

Q I see.

A I pointed out there was an underwriting in '74 for 1,823,000 shares which had been sold by July, but that underwriting was filed in March.

MR. BLUM: May I have the witness instructed to answer the question?

THE COURT: In that instance you opened the door.

MR. BLUM: Let's see if we can't do something with that door.

THE COURT: You asked an argumentative question and he gave you an argumentative answer.

MR. BLUM: Sure did. Let me see if I can't do something.

Q In your opinion, were economic times in 1972 better or worse than economic times in 1974?

MR. GOLDSTEIN: Objection, your Honor. Again, we're two years before Mrs. Grupe purchased the securities.

MR. BLUM: I think the relevance of that question is clear.

THE COURT: I don't see it, but I'll allow it.

A What's your question, sir?

Q My question was: Did you regard -- do you regard the economic climate of 1972 as being a better or a more perilous economic climate than the spring of 1974?

A Probably about the same.

Q Now, you talked about depreciation, money in the till. Mr. Lamula, is it not a fact depreciation is nothing but a bookkeeping entry of a corporation indicating a reduction in their evaluation of assets?

A Yes, but the cash stays in your pocket.

Q What cash, Mr. Lamula?

A The cash they take for depreciation.

Q You believe that the indication of a depreciation -- of a depreciation item represents cash set aside by the company?

A Without question. Would you like me to prove it to you?

Q No.

A Don't you want the jury to know?

THE COURT: Your attorney will have an opportunity on redirect to clarify that.

MR. BLUM: I think they may have that opportunity.

Q Isn't it a fact that in that annual report, which you say you reviewed with Mrs. Grupe, shows a deficit net worth of $8.5 million for Allegheny, a deficit net worth of $8.5 million?

A It's always a fact --

Q Is it or not so?

MR. BLUM: I request the witness be instructed to answer.

THE COURT: Answer the question.

A Yes.

Q Did you advise Mrs. Grupe of that fact when you recommended these debentures?

A Of course.

Q I see. Isn't it true also that at the time you sold Mrs. Grupe these debentures the company had ceased paying dividends on its preferred and common stock?

A But not on the debentures.

Q Is it or not true?

A But not on the debentures.

Q Is it or is it not true --

THE COURT: Answer the question.

Q -- that it had ceased paying, that it was not paying dividends on its common stock?

A No, you are wrong.

Q Was it paying dividends on common stock?

A Yes, they paid a 3 percent stock dividend in

'72 and 10 percent stock dividend in '73 and continued to pay.

Q Did they pay any cash dividend on their common stock?

A They paid a stock dividend.

Q Did they pay any cash dividend?

A Anybody that gets a stock dividend can sell it and convert it to cash. It's a dividend. You asked a dividend, sir.

Q It was paying stock dividends, not cash?

A They paid a dividend, they paid a dividend in stock.

Q Now, was preferred stock --

A Why didn't you know it was paying a dividend? It's right here.

THE COURT: Mr. Lamula, he asks the questions and you answer them.

Q Was the preferred stock paying a dividend at the time you sold these debentures of Allegheny to Mrs. Grupe?

THE COURT: Your question is cash dividends?

MR. BLUM: Any kind of dividend, and then we'll go from there.

A That dividend was cumulative and since paid.

Q It was not paying the preferred dividend at the time?

A No, but the debenture comes before, and the interest has to be paid.

Q Did you regard it -- you did not regard it as relevant to whether or not the debenture was safe?

A I regarded the debentures as safe because the interest had to be paid.

Q Preferred stock is senior, is it not, to common stock?

A Yes, but behind the debentures.

Q Yes or no.

A Behind the debentures.

Q It was next, behind the debentures?

A Yes, the debentures come first and they had cut their debentures down from 20 million to 10 million.

Q Did you tell Mrs. Grupe that the issue that came next behind her debentures had stopped paying dividends?

A That had no relevancy.

Q You didn't advise her of that?

A It had no relevancy.

Q Did you or did you not advise her?

A I advised her the interest had been paid from 1968.

Q Did you or did you not advise her?

A I didn't go into the question.

MR. BLUM: Thank you.

THE COURT: This might be an appropriate time to break for luncheon recess. Excuse the jury. I again caution you not to discuss the case.

Counsel will remain.

(Jury excused)

THE COURT: Let the record reflect the jury has been excused. Mr. Lamula, you must not argue with the questions being asked of you, nor must you volunteer additional answers. Your attorney will have an opportunity to clarify any matters you feel have been left by the questions asked and answers given.

How much more do you mean to be with this witness? I ask you in terms of your problems.

MR. BLUM: If it's shortened down, I think anothe hour or hour and a half.

THE COURT: Is it arranged with Mr. Loeb?

MR. BLUM: Yes. There is no way he would be reached before 3.

THE COURT: Tell him to be here at 3.

MR. GOLDSTEIN: Your Honor, I wish to advise the Court we are not going to call Moody's or Standard &

Poor's. We have arranged with them, so that will cut down the time.

THE COURT: What other witnesses do you have after Mr. Loeb?

MR. GOLDSTEIN: I do not think we have to call Minnie Vena. If we did, it would be a short time. We do intend to call Mrs. Grupe.

THE COURT: It appears we are going to run into tomorrow and probably finish sometime tomorrow.

MR. GOLDSTEIN: Yes.

MR. BLUM: I have at this point one rebuttal witness. I advised my colleague of his name. He is the partner of trading at L. F. Rothschild.

THE COURT: We may run all day tomorrow.

MR. BLUM: I would think that's likely. The best calculation, we would be ready for summation by late afternoon tomorrow.

THE COURT: OK.

(Luncheon recess)

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss .

JULIO VALLEJO, JR., being duly sworn, deposes and says that deponent is not a party to the action, is over 18 years of age and resides at 703 REMSEN AVE. BROOKLYN, NYC.

That on the 25th day of APRIL, 1977, deponent personally served the within JOINT APPENDIX - VOLUME II OF III upon the attorneys designated below who represent the indicated parties in this action and at the addresses below stated which are those that have been designated by said attorneys for that purpose.

By leaving 1 true cop~~ies~~y of same with a duly authorized person at their designated office.

~~By depositing ____ true copies of same enclosed in a postpaid properly addressed wrapper, in the post office or official depository under the exclusive care and custody of the United States post office department within the State of New York.~~

Names of attorneys served, together with the names of the clients represented and the attorneys' designated addresses.

SILBERFELD, DANZIGER & BANGSER
Attorneys for Plaintiff-Appellee
230 Park Ave.
New York, N. Y. 10017

Julio Vallejo, Jr.

Sworn to before me this

25th day of APRIL, 19 77.

Michael DeSantis
MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Queens County
Commission Expires March 30, 1979